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Corrections & Clarifications

In "A Tech Dealmaker Mounts a Comeback" (Markets & Finance, Jan. 24), we reported that Qatalyst Partners cannot underwrite initial public offerings. In fact, it can. We regret the error.

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Opening Remarks



Just Like Starting Over

Why is Obama suddenly blowing kisses at the U.S. Chamber of Commerce?
By Devin Leonard

The U.S. Chamber of Commerce's headquarters in Washington, D.C., is just across Lafayette Park from the White House. President Barack Obama, however, has only been there twice since he was elected. He had good reason to stay away. During Obama's first two years in office, the trade association's president, Thomas J. Donohue, a 72-year-old as pugnacious as Jimmy Cagney, did everything in his power to derail the President's agenda.

He warned that the White House-backed health-care bill would impose "a burdensome mandate on employers." He compared the Dodd-Frank financial reforms to Pandora's box. And he didn't just bark; he bit. The Chamber, which represents businesses big and small, spent more than $32 million before the midterm elections on "issue ads" primarily targeting Democratic lawmakers who voted for such legislation. Donohue liked to say none of this was intended to antagonize the President. It was just business.

As part of his larger overture to private sector, Obama is determined to put these bad memories behind him. On Feb. 7 he will visit Donohue's fortress and deliver a speech about jobs and the economy. "We are looking forward to the President's visit, but do not have any details about the event yet," said Blair Latoff, a Chamber spokesman, in an e-mail. You can be sure Obama's business-friendly message will be parsed almost as closely as the one in his State of the Union speech.

The President is likely to repeat many of the themes of the earlier speech, including calls for increasing investment in infrastructure and education, lowering corporate taxes, and freezing discretionary spending to pare down the deficit. "We have to make America the best place on earth to do business," Obama said in his Jan. 25 address.

At least one important listener seemed to get the message: Donohue. In a response posted on the Chamber's website, the lobbyist singled out pro-business highlights and said it was time for the White House, Congress, and the private sector to pull together and get them done. It wasn't an overwhelming endorsement, but given the Chamber's prior critiques, it was probably the best the Administration could expect. Presumably, the good feelings will survive for at least a week. If the antagonists find it in their interests to extend the detente, this could turn into an affair to remember.

Obama's overtures have everything to do with his effort to reboot his Presidency after his Nov. 2 "shellacking" at the polls. Within weeks of that debacle, the President put the finishing touches on a trade agreement with South Korea. He negotiated an extension of the Bush tax cuts with congressional Republicans. He ordered a review of federal regulations to see if any might impede economic growth. He appointed William Daley, a former banker for JPMorgan Chase, as his chief of staff, and named General Electric CEO Jeffery Immelt as the head of his outside panel of economic advisers.

Obama has kept the Chamber busy responding to this fusillade of valentines. Donohue called Daley "a strong appointment." He referred to the selection of Immelt as "a promising step." And in his recent State of American Business 2011 speech, he lauded "a new tone coming out of the White House." Administration officials are pleased. "I think the President's approach is, he doesn't have to agree with you on every matter," says Valerie B. Jarrett, a White House senior adviser. "By praising us for the steps we have recently taken, the Chamber has demonstrated their willingness to work with us, too."

If Donohue is skeptical about the President's newly conciliatory stance, he isn't about to say so yet. Some of his allies are less circumspect. "There are all sorts of steps that this Administration has taken

PHOTO ILLUSTRATION BY EMILY KEEGIN & MAAYAN PEARL; OBAMA: BRENDAN SMIALOWSKI/BLOOMBERG; DONAHUE: TOM WILLIAMS/ROLL CALL/GETTY IMAGES



that clearly suggest they have a fresh and refreshing attitude about their relationship with the business community—at least stylistically," says Dirk Van Dongen, president of the National Association of Wholesaler-Distributors. Similarly, some of Obama's liberal supporters, who won't forgive Donohue for helping to thwart Obama's agenda, have been quick to react. "It's weirdly counterproductive or terribly craven," says Cenk Uygur, an MSNBC contributor and host of The Young Turks, a liberal Web talk show. "I don't know whether the President understands this is his political opponent. Donohue is doing everything he can to destroy his Presidency and his party."

The overtures to business, however, aren't just optics. They have a specific goal. Obama knows as well as anybody that the biggest obstacle to his reelection is the nation's unemployment rate, still hovering north of 9 percent. With the Republican Party in control of the House of Representatives, the President has no chance of passing another big stimulus bill to get Americans back to work.

There is, however, $2 trillion lying around that could work similar wonders. This is the record mountain of cash that U.S. corporations have amassed while waiting to see how the economic recovery unfolds. "The reason they have been reluctant to spend is their general lack of confidence," says Mark Zandi, chief economist at Moody's Analytics. "They have just been through the nightmare of the Great Recession. They were also shaken by the vitriol that accompanies some of the recent policy debates. It just created all this uncertainty."

For Obama, the goal is to get the nation's businesses to invest some of this money and accelerate the hiring process. Jonathan Cowan, president of Third Way, a centrist Democrat group, says that the White House's outreach to the Chamber will certainly help persuade businesses to open their wallets. "The Administration was getting a lot of pressure from the left to take a very anti-business populist point of view," he says. "There was a widespread belief in that as the right thing both substantively and politically. It came to realize that didn't work. It deeply alienated the private sector."

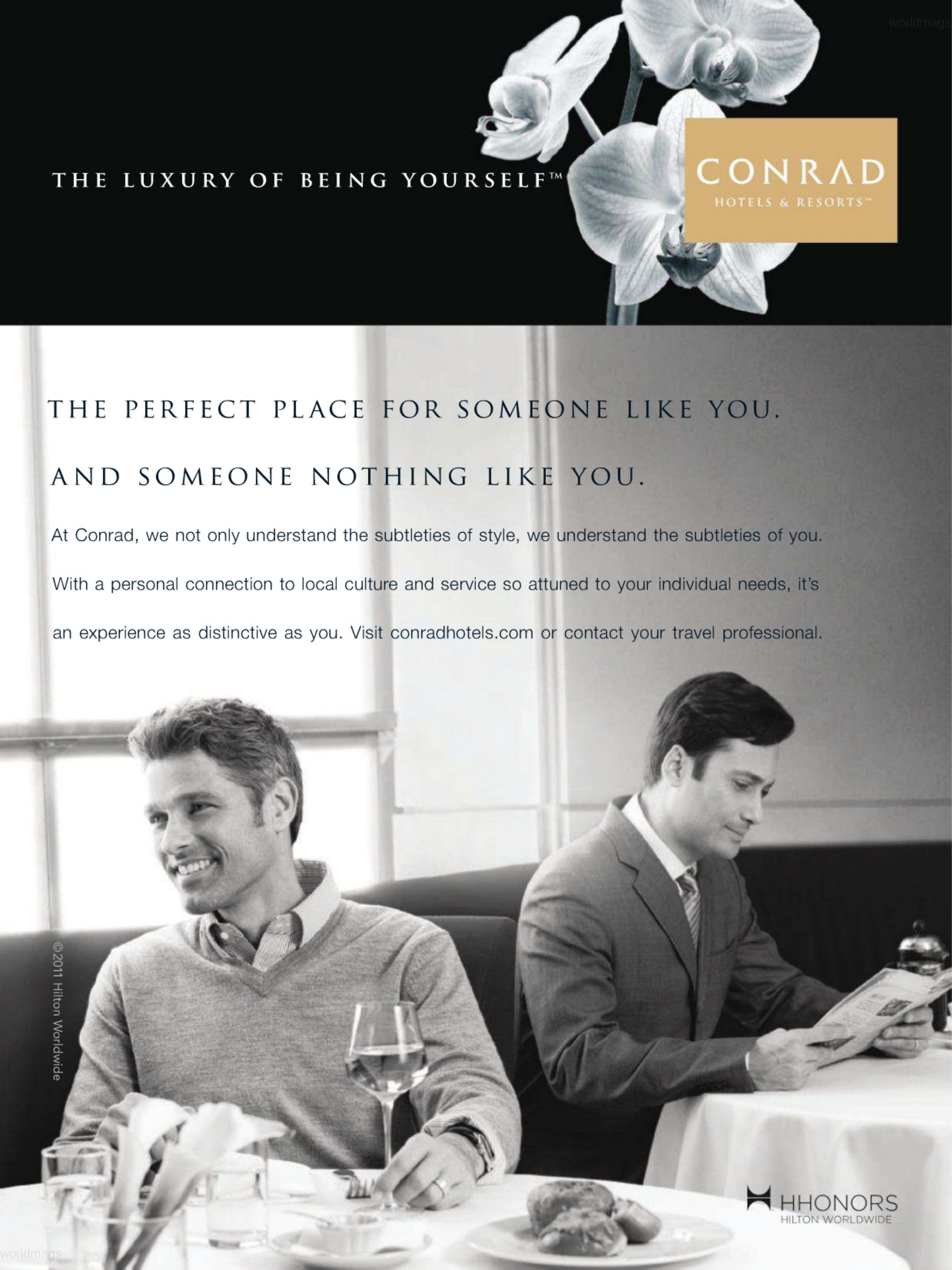
Although the White House always denied it was sending anti-business signals before, it is certainly sending pro-business ones now. This is surely smart politics—Obama's version of the triangulation theme that his Democratic predecessor Bill Clinton deployed so successfully after he took a shellacking of his own in 1994. Clinton adopted traditionally conservative issues like welfare reform, making it harder for Republicans to portray him as an out-of-control liberal. He went after them on their ideological turf. Obama may try something similar now. And Donohue might even give him a hand.

The Republican Party today is an uneasy alliance of corporate conservatives who are comfortable working with government and Tea Party supporters who virulently oppose such tactics. By allying itself with the Chamber on specific issues, the White House may drive a wedge between the two and forge a centrist coalition that—unlikely as it may seem—could actually get something done.

Chamber President Tom Donohue spent $32 million to kill Obama's agenda. Can they be friends after that?

The Chamber, for example, is strongly in favor of increased spending on infrastructure and continued support for education. The White House has enthusiastically embraced this as well. Many congressional Republicans, intent on deficit reduction, aren't so sure. When they unveiled plans that could lead to cuts in the Highway Trust Fund, Donohue reprimanded them. "I don't think that's such a good idea," he said. At the same time, Donohue has distanced himself from Senate Minority Leader Mitch McConnell's talk of spending the next two years laying the groundwork for Obama's defeat. "It's not our intention to weaken the President in any way," he said after the midterm election. "We are ready to walk across this park and work with the Administration on any issue."

Still, any Obama-Donohue alliance will be purely situational. The two will fight at least as often as they make common cause. In his State of American Business address, Donohue continued to blast the health-care bill, the President's signature achievement, calling for its repeal. But who knows: Maybe Obama will invite Donohue over to the White House to catch a Chicago Bulls game on the tube. Maybe they can agree to disagree on health care. They do have more in common these days. And with enemies like this, the President may be wondering, who needs friends? Ⓑ



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While the Rich Splurge, The Rest Hold Back

▶ **Buoyed by stock gains, the well-to-do outspend the middle class**

▶ **"Financial uncertainty still weighs heavily on everyday Americans"**

Wealthy shoppers are bolstering the recovery—and masking the reluctance of many less affluent Americans to join in. Sales are up at **Tiffany** and **Coach**, thanks to demand for $6,000 diamond pendants and $1,200 leather handbags as a stock market surge pads the wallets of the rich.

At the other end of the economic spectrum, **Wal-Mart Stores**, the world's largest discount retailer, reports that many of its customers are still living paycheck to paycheck as they await an improvement in job prospects. That means they stick with the essentials. "Financial uncertainty still weighs heavily on everyday Americans," said Mike Duke, the Bentonville (Ark.) company's chief executive officer, in a Nov. 16 conference call with investors.

Those ordinary Americans who have jobs worry about holding onto them, and they expect few if any increases in pay as the recovery inches forward. For upper-income households, it's a different story, says Michael Feroli, a former Federal Reserve economist who is now chief U.S. economist at JPMorgan Chase in New York: "They're the ones benefiting the most from the stock market rally, and they're spending."

Consumer spending accounts for about 70 percent of the economy, and the uneven pattern in household expenditures helps explain why Fed policymakers will likely keep interest rates near zero while carrying on with a second round of Treasury purchases aimed at getting credit flowing again. Unemployment averaged 9.6 percent last year, the highest rate since 1983, even as the expansion gathered speed. Feroli estimates the top 20 percent of income earners account for about 40 percent of spending. Dean Maki, chief U.S. economist at Barclays Capital in New York, puts the figure at closer to 50 percent.

High-end retailers such as Tiffany and Coach led the increase in December sales at stores open at least a year

High-end retailers led the increase in December sales at stores open at least a year, company data showed on Jan. 6. The Bloomberg Retail Sales Luxury Index of U.S. sales revenue jumped 8.1 percent from the same month a year earlier, while the Bloomberg Retail Sales Discount Index eked out a 0.9 percent rise. Purchases made in the third quarter with **American Express** credit cards, carried by relatively wealthy and corporate customers, were back to the most recent peak for a third quarter, which was reached in 2008. The combined total for **Visa** and

ILLUSTRATION BY AL MURPHY

MasterCard didn't experience a similar rebound, according to company data.

The U.S. lost about 8 million jobs during the recession, and Fed Chairman Ben Bernanke said in Senate testimony on Jan. 7 that employers remain reluctant to hire. Payrolls expanded by 103,000 workers in December, less than the median forecast of economists surveyed by Bloomberg News. A healthier labor market would put more money in the hands of shoppers across the board, further lifting consumption. In the meantime, rising stock prices signal that rich shoppers will retain an edge in driving spending. The top 20 percent of income earners account for about 80 percent of equity wealth and half of housing wealth, Maki estimates.

The Standard & Poor's 500-stock index has almost doubled from its March 2009 low. On top of that, President Barack Obama on Dec. 17 signed into law a bill extending Bush-era tax cuts for all income groups, instead of letting them expire for families earnings more $250,000 a year, the cutoff the Administration uses for the middle class. "It's striking," says Dean Baker, co-director of the Washington-based Center for Economic and Policy Research. "Most of the rest of the country is still suffering while the wealthy seem to be largely insulated. You would think they wouldn't have all that much to complain about. Instead, they've had unending criticism for the Obama Administration."

Sentiment data reflect the stock market gains. The Conference Board's Consumer Confidence Index for households making more than $50,000 a year hit a 33-month high in January, while the gauges for households earning under $50,000 a year are still below their levels of last May. Rising foreclosures and declining real estate values indicate middle- and lower-income households will remain cash-strapped. The asset value of property held by Americans fell by $649 billion in the third quarter, to $16.6 trillion, the Fed said on Dec. 9. Home prices may drop as much as 11 percent through the first quarter of 2012, which would leave them 36 percent below their 2006 peak, according to a Dec. 8 Morgan Stanley report.

For companies that cater both to the well-off and those of modest means, the divergence is striking. There's been "a greater bounceback in the more affluent customer," says Clarence Otis, chief executive officer of **Darden Restaurants**. The Orlando company owns casual-dining chains such as Red Lobster and Olive Garden as well as the upscale Capital Grille steakhouses. On a Dec. 21 conference call with investors, Darden's chief operating officer, Andrew Madsen, noted that "less affluent guests who tend to have a lower check are reducing their restaurant visits."

Maki, for one, expects consumption patterns to normalize as the year moves forward. "The labor market recovery will become more widespread as we go through 2011, which should take away some of the imbalance" in purchases, says the economist, who specialized in researching household finances at the Fed from 1995 to 2000. "We definitely expect to see some catch-up in spending by middle- and lower-income households. It's one of the ways the recovery will become more entrenched."

—*Shobhana Chandra and Anthony Feld*

The bottom line *Strong Christmas sales numbers obscure the discrepancy between increased shopping by the affluent and cautious spending by the rest.*

4.4

PERCENT

The International Monetary Fund's revised forecast for global GDP growth in 2011, up from 4.2 percent.

DATA: INTERNATIONAL MONETARY FUND



Merkel's renewed pledge to defend the euro has calmed markets

Currencies

Where Have All the Euro Bears Gone?

▶ Shorting the troubled currency is no longer the sport of the day

▶ "We support whatever is needed to support the euro"

Speculators placing bets against the euro are retreating in the face of tough talk from German Chancellor Angela Merkel. Traders are starting to believe her when she says Germany will do whatever it takes to safeguard Europe's common currency. The euro has gained almost 6 percent against the dollar since Jan. 10. Demand for contracts used to hedge against a drop in the euro has rapidly evaporated. "Euro zone policymakers are finally moving ahead of the curve," says Thomas Stolper, chief currency strategist at Goldman Sachs in London. "It's getting more difficult for the skeptics to find a crack in the euro."

In January, Germany joined euro zone finance ministers for the first time in saying it is contemplating expanding a financial bulwark designed to repel the most aggressive speculators. "We support whatever is needed to support the euro," Merkel told reporters on Jan. 12.

The EU has already agreed to bail out Greece and Ireland. Bond investors fear that Portugal and possibly Belgium and Spain could be next. A group of European finance ministers met on Jan. 17 to discuss expanding the EU's €440 billion ($599 billion) rescue fund, although no

Heading to Hamburger U. in China page 22 ▶

agreement was reached. The European Financial Stability Facility (EFSF), which has already come to the aid of Ireland, is empowered to issue bonds and other types of debt. Proceeds from those sales will then be funneled to needy nations as loans. The ultimate goal: to avoid a debt default by one of the members of the euro club, an event that could cause investors to flee the currency.

European efforts to shore up the currency are getting an assist from outside the region. Japan snapped up more than 20 percent of the EFSF's initial five-year bond issue. Chinese Vice-Commerce Minister Gao Hucheng, while on a visit to Madrid in early January, said China will buy Spanish public debt. "You have to take the broadening of the safety net as a good development for the euro zone," says Paul Mackel, director of currency strategy at HSBC Holdings in London.

Another reason for the euro rally is that, for all of the focus on Europe's debt crisis, the region's economy has shown signs of improvement. In Germany, the gauge of business confidence published by the Ifo Institute for Economic Research hit an historic high in January. An index of sentiment among French factory managers rose more than expected in December, France's national statistics office reported.

Despite the encouraging indicators, some forecasters say the euro's rebound won't last. John R. Taylor, chairman of FX Concepts, the world's largest currency hedge fund firm, said on Jan. 5 that the euro may fall below parity with the dollar this year. Shaun Osborne, chief currency strategist at TD Securities, predicts a decline to $1.05 by the third quarter.

These euro bears are now in the minority. Futures traders reversed bets that the euro will weaken against the dollar, figures from the Commodity Futures Trading Commission show. The difference in the number of wagers by hedge funds and other large speculators on a gain by the euro compared with those on a drop–so-called net longs–was 4,109 on Jan. 18, compared with net shorts of 45,182 the week before. Says Goldman Sachs's Stolper: "The fast-acting speculative community has probably closed out most of their shorts."
—*Matthew Brown and Lucy Meakin*

The bottom line *The euro has rallied, powered by German support for the single currency and encouraging economic indicators on the Continent.*

Income Equality

Chinese Workers Find Prosperity Elusive

▶ **Hidden income and kickbacks benefit rich elites, not the masses**

▶ **"With rising prices, people feel their quality of life has gone down"**

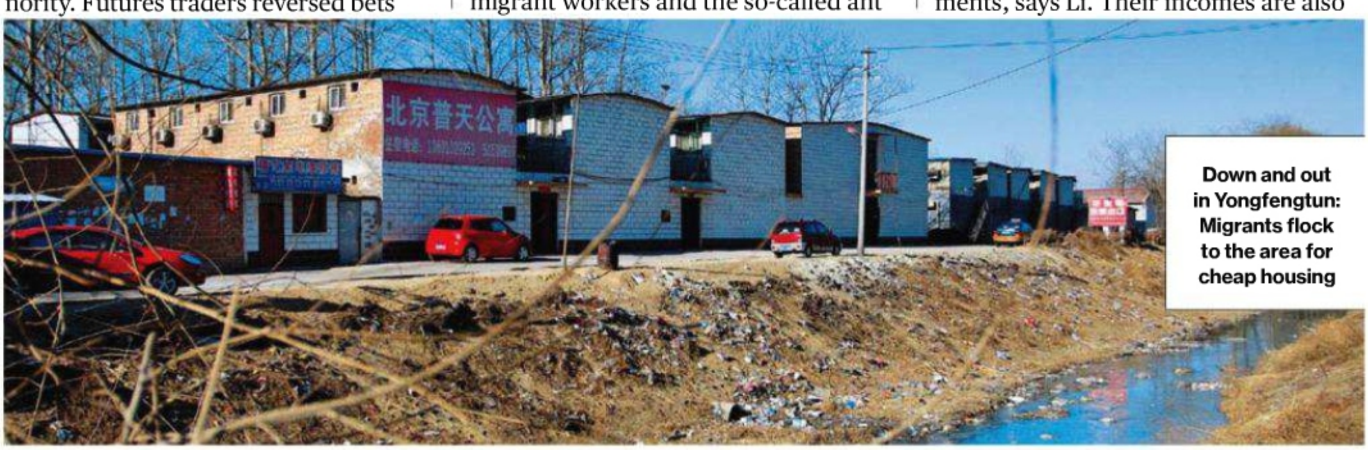
It takes about three hours by bus from the glitzy malls of central Beijing to reach Yongfengtun, a farming village northwest of the capital that has quadrupled in population, to 20,000, over the past few years. Here one finds a gritty version of a Chinese bedroom community. Grimy storefronts advertise cheap clothing, shoes, and budget mobile-phone service. Mangy dogs root through piles of trash on the bicycle- and pedestrian-crowded streets.

Yongfengtun's streets may be rundown, yet they attract thousands of migrant workers and the so-called ant tribe (cash-strapped urban youth) from across all China. "It's cheap!" says one 23-year-old, a recent college graduate who pays $39 a month for a 65-square-foot apartment. "Heat costs money," he says ruefully as he kicks a pan of water for washing laundry that has frozen solid. "There is no way I could afford an apartment in central Beijing," with rents probably 10 times higher for a comparable place, he says.

It's not as if incomes are stagnant in China–anything but. In the first half of 2010 per capita income rose 13 percent in the countryside, to $935 a year, and 10 percent in the cities, to $2,965 a year. Nevertheless, swelling slums in the suburbs of Beijing, Shanghai, and Guangzhou attest to a yawning wealth discrepancy between thousands of newly minted rich and millions of poor.

China already is showing levels of inequality comparable to the Philippines and Russia and is far less egalitarian than Japan, the U.S., and even Eastern Europe, according to Li Shi, an authority on income distribution trends at Beijing Normal University. Official figures show rural incomes are less than one-third those in cities, with the top 10 percent of urban Chinese earning about 23 times that of the poorest 10 percent–a ratio that is almost certainly understated, according to Li. "You can find increasing income inequality almost everywhere in China today," he says.

One reason is a system that blocks an estimated 150 million or more rural migrant workers from gaining access to benefits such as health care, education, and pensions available to urban residents. As a result, migrants are forced to save more of their wages to cover medical expenses and their retirements, says Li. Their incomes are also



Down and out in Yongfengtun: Migrants flock to the area for cheap housing

CLOCKWISE FROM TOP RIGHT: AP PHOTO; ZHAN MIN/IMAGINECHINA; ALL CANADA PHOTOS/ALAMY; MICHELE TANTUSSI/BLOOMBERG

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getting pinched by higher food prices (inflation is hovering around 5 percent) and rising housing prices (up 6.4 percent in December on an annual basis).

China's Gini coefficient, an income distribution gauge used by economists, worsened from below 0.3 a quarter-century ago to near 0.5 today, says Li. (The measure, named after Italian statistician Corrado Gini, ranges from 0 to 1.) Poverty researchers recognize anything above 0.4 as potentially socially destabilizing.

China's wealth gap may be worse than official statistics indicate. The incomes of better-off families are understated, says Wang Xiaolu, an economist at the independent National Economic Research Institute in Beijing.

Undisclosed income, which Wang says could add up to $1.4 trillion annually, ranges from kickbacks to businesses or government to perks such as subsidized housing offered by state-run companies. If so, the wealthiest 10 percent of the population earned 65 times that of poorest 10 percent–not the 23 times shown by government data.

President Hu Jintao's government is keenly aware of the problem. Policies aimed at lifting incomes include the 2006 abolishment of the agricultural tax, new central and local government mandates to fund nine years of free education, improved health care, and the construction of low-income housing.

Further narrowing of the income gap will require changes in fiscal policy, says Louis Kuijs, a World Bank economist in Beijing. Expanding government revenues beyond taxes on wages to include levies on property, as well as on income earned from capital gains on real estate and stocks, is one step, say Kuijs and economist Wang. Continued reform of China's household registration system, to allow migrants more access to social welfare benefits, is also necessary. A survey done last September by Horizon Research Consultancy Group, a Beijing researcher, showed a drop in life satisfaction and declining confidence about China's future, despite the country's double-digit growth rates. With food and housing prices rising, "people feel their quality of life has gone down," says Victor Yuan, founder and chairman of Horizon.

—Dexter Roberts

The bottom line *The gap between rich and poor in China is wider than generally realized and could create political problems for Beijing.*



Japan's 100-yen shops are thriving as workers' pay continues to fall

Prices

Japan Learns to Live With Deflation

▶ Lower wages, yet cheaper TVs, burgers, and golf

▶ "It's not like I'm promised any pay raises. I hope prices keep falling"

Ben Bernanke has been lecturing on deflation's perils since he joined the Federal Reserve in 2002 and has often held up Japan as Exhibit A. When the Fed launched QE2, the quantitative easing program to promote credit expansion in the U.S., in November, the central bank chief hoped to avoid the scourge that has devastated Japan's economy. U.S. consumer prices, excluding food and fuel, climbed at their slowest pace since records began in 1959, the Commerce Dept. reported on Dec. 22.

There's something curious about the way the deflation syndrome has played out in Japan, though. The Japanese don't feel that threatened anymore. "Everyone knew deflation was bad for jobs and bad for the economy, but gradually households and companies just got used to it," says Martin Schulz, a senior economist at Tokyo's Fujitsu Research Institute.

Deflation–the steady drop in prices of goods, wages, and services–has many ill effects. Households are stuck paying off mortgages, car loans, and other debt even as their take-home pay has declined. Also, as housing values fall, consumers have smaller nest eggs for retirement. Companies, meanwhile, are unable to raise prices, which puts pressure on profits.

Yet the Japanese have discovered the benefits of deflation as well. Monthly pay dropped to an average 315,294 yen ($3,800) in 2009, the lowest level since the government began tracking wage data in 1990. "It's not like I'm promised any pay raises," says Momoko Noguchi. The 24-year-old Tokyo resident gets by on two part-time jobs by shopping for everything from nail polish to dinner plates at her local 100-yen outlet (the Japanese equivalent of an American dollar store), and she pays 400 yen or less for lunch. "I hope prices keep falling." Four out of five Japanese say higher costs would be "unfavorable," according to a central bank survey.

Faced with consumers such as Nogu-

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chi, companies in Japan have actually accelerated deflation. Retailers "have poured a lot of energy into offering products that are cheap but still have high value," says Naozumi Nishimura, an analyst at TIW in Tokyo. "We're seeing some good effects from that."

To help reverse a seven-year decline in same-store sales, **McDonald's Holdings Japan**, a unit of **McDonald's**, introduced a 100-yen menu in 2005. The chain's 100-yen hamburger sold for 210 yen in 1990. "We wanted our customers to know that we've changed," says Kazuyuki Hagiwara, Tokyo-based senior marketing manager at the company. Since the debut of the lower-priced menu, same-store sales have climbed every year. McDonald's Japan shares have returned 17 percent in the past three years.

Price cutting by companies has helped Japanese consumers adjust to deflation. The average household owns 1.4 cars and 2.4 color TVs, about a quarter more than in 1990, a Cabinet Office survey shows. Deflation has helped home buyers, too, by forcing prices down from their peaks in 1990: According to calculations based on yearly Land Ministry data, Japan's residential land prices have dropped by an average of 2.9 percent a year over the past two decades.

Golfers pay 26,800 yen ($324) to play on the weekend with a caddy at the Bobby Jones Jr.-designed Oak Hills Country Club, 90 minutes' drive from central Tokyo. Twenty years ago the fee was about 40,000 yen, says Katsutoshi Ohira, acting manager. All told, the proportion of people content with their standard of living was 63.9 percent last year, compared with 63.1 percent in 1989, a government report said.

Deflation is so entrenched in Japan that companies are exporting it. **Fast Retailing** plans to open 44 Uniqlo stores overseas this fiscal year. Supermarket chain **Aeon** has earmarked about $2.5 billion over three years to open stores in China and Southeast Asia. **Daiso Industries,** which dominates the 100-yen retail sector, now has outlets in more than 20 countries.

In Japan, where 23 percent of the population is over 65, a sudden rebound in prices would hurt pensioners and retirees especially hard. "It's amazing what you can buy with 100 yen now. We didn't have 100-yen stores before," says Sachiko Enokida, 80, who lives on her bimonthly pension checks from the government. "I would hate for things to get expensive again."

So is deflation a blessing in disguise? Not to analysts such as Richard Jerram, head of Asian economics at Macquarie Securities. He points out that as businesses cut prices to compete, it becomes harder to borrow and invest. "It's extremely corrosive," he says. Deflation, adds Jerram, will steadily sap Japan's nominal growth and deprive the government of tax revenue. Eventually, Japan may no longer be able to finance its borrowing. The country will then either have to default on debt that's about twice the size of the economy or devalue its currency to reduce the real value of liabilities. "That's the unavoidable endgame," says Jerram, who has analyzed the Japanese economy since 1987. "As long as it's in the future, everybody can pretend it's someone else's problem." —*Aki Ito*

The bottom line *Although deflation ultimately poses a serious threat to Japan, ordinary consumers are benefiting from lower prices.*

Commodities

In France, There's Pain in the Rising Cost of *Pain*

▶ Bakers are passing higher costs on as wheat prices soar

▶ The baguette "is a psychological indicator," says a Paris economist

"Liberty and baked bread" are all people really need, goes an old French proverb. One of those necessities is about to get more expensive as bakeries raise baguette prices to pass along surging grain costs. "We have no choice," says Michel Galloyer, who runs a dozen **Le Grenier à Pain** stores in Paris. "Wheat

➔ 17



A perennial symbol of France, despite declining consumption

Tom Keene's EconoChat

Tom talks with **Edward Morse**, head of commodities research at Credit Suisse, about the outlook for the oil market this year and beyond

Are we going to go to $100 a barrel? It seems to be a certitude out there.
There might be a surge above $100, but I suspect we've seen the highs, if not for the season, then for the year. The market is going to sell off and get softer.

What are you most focused on right now?
What gets my attention are the one-off factors that led to the rally in the last half of the year, like the French refinery strike. We've seen those factors dissipating. The winter was clearly a strong winter of demand because of weather, but that, too, is coming to an end.

Is peak oil discredited as a theory?
The peak oil guys are like the guys who didn't like the Cold War ending in the late 1980s. They keep looking for more evidence, but they are finding it harder and harder to define that peak oil is here. We're about to see North Dakota become a bigger producer of oil than Alaska. There is oil wherever people are putting holes in the ground.

What is the outlook for supply as we move into the new decade?
There is an incredible amount of offshore deepwater finds in the world. One that has been in the news lately is the Leviathan natural gas find off of Israel. Iraq is the other big factor. It looks already this year as if they're going to be adding 300,000 to 500,000 barrels a day, and the market hasn't quite adapted to that yet.



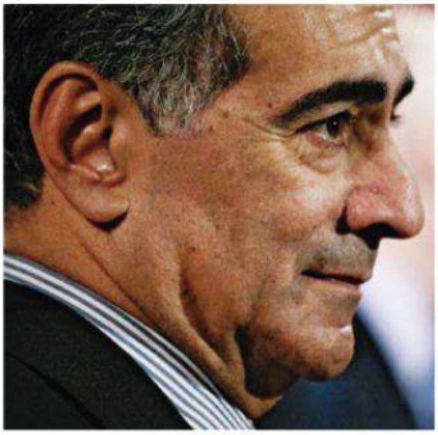
Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

FROM LEFT: JEREMIE SOUTEYRAT; ETSA/CORBIS; ANDREW HARRER/BLOOMBERG

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Charlie Rose talks to John Mack

"[The Chinese] don't want to see outside companies come in and take control"



The Morgan Stanley chairman, who is also an adviser to China's $300 billion sovereign wealth fund, offers his take on U.S.-China business ties following Hu Jintao's visit

Were U.S. business leaders satisfied with their conversation with Hu and the U.S.-China summit? Do they see change coming?
Anytime there can be a direct dialogue, CEOs find that helpful. What the Chinese want, I think, is a better understanding, having the U.S. really understand what they're trying to do. I was there in December, and I had a discussion with one of the vice-premiers. He talked about our congressmen, our senators, coming to visit him and saying, You should be doing this, you should be doing that. ... He said: "I've read over 100 books about your country. I know something about your culture, but I'm not an expert. To come and preach to me what our country should do when you really don't have an understanding, I find very resentful."

One of the things I've found as a businessperson: Our elected politicians don't travel enough. To understand the Chinese and to get along ... we need more meetings like what took place with the CEOs and Hu Jintao. And then kind of cajole and push and say why certain things should work and certain things wouldn't work. That's the dialogue I think they're looking for. They really want to work together, and work with us.

What's the goal of this dialogue?
To build relationships. The Chinese ... want to trust the people they're doing business with. You can't just fly in and fly out. The first—I'm going to guess—25 times I went to China, I didn't do any business. The first piece of business that we got was a power project. We raised debt money. I finally said to the minister, "Why did you give me this business?" And I laughed at his answer. He said: "You're the only bank that has come without a lawyer. You trust us."

Do they recognize that there's a belief among some businesspeople that they want to learn what you can teach them and then say goodbye?
We can't forget, this is still an emerging market. Really, it wasn't until the late '80s, early '90s, that they started making this huge change in their economy. So you can understand why they don't want to see outside companies come in and take control of their major businesses. They have to be cautious. But at the same time, I think if you build the sense of trust and communications over time, some of the complaints that we have will go away. Look at General Motors. General Motors sells a lot of cars [there].

The Chinese like their Buicks, right?
It's been one of their best businesses. Do they own 100 percent of it? No. But I would argue, in China you want to have a local partner, and you want to make sure it's fair. It takes time, and I think our time frame is very short. Their time frame is very long, and they have issues they have to address. One of the big ones is unemployment. I think they have to create over 25 million jobs a year. You have this whole movement from the agricultural sector into these urban centers, and you need to create jobs to do that. So you could understand why they have to be somewhat cautious. But at the same time, I've never dealt with any group around the world who are [more] open to ideas ... and who make sure that you get the right return on your investment. Are there places where someone has copied things? The answer is yes, but that's not just in China. Do they do some things that upset people? Absolutely, they do.

There are a lot more Chinese students studying in the U.S. than Americans studying in China.
That's right. And I think that's changing. But these students are going to go back to China. They're going to have a different view of things. I think things will change in China.

One of the questions that keeps coming up—in the U.S. and everywhere else—concerns whether America is in decline.
Well, one thing that you have to change—we owe so much money. We have such a large deficit. Clearly, that, I think, saps a lot of our power to be as creative as we should be. But I do not hold the view that America is in decline. I believe we have, you know, ups and downs.

Are the Chinese worried that their economy is expanding too fast, that inflation will get out of control?
They're very concerned about inflation and what it could do to their economy. But again, after having said that, I think they're very focused on it. Their central bank is very focused on it. And they get a lot of advice from people from the outside.

You urge people to go to China. And then you ask them how many books they've read.
I don't ask them about the books. I just want them to go.



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

FROM TOP: MARK LENNIHAN/AP PHOTO; BRAD TRENT

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Global Economics

prices have exploded." Galloyer, whose €1.10 ($1.56) baguettes were voted the best in the French capital last year, says he'll have to charge 5¢ more when flour prices start to rise, likely in February.

Wheat prices have almost doubled in the past 12 months as a drought in Russia and floods in Canada and Australia wiped out crops. On the NYSE Liffe options exchange in Paris, March-delivery wheat closed at $364 a metric ton on Jan. 25, up 85 percent from a year earlier.

The French consume about 23 million baguettes a day, supplied by 33,000 bakeries and mass retailers such as **Carrefour**, the National Association of French Millers estimates. Since 2007, another bad year for wheat, the price of a baguette at the corner bakeries that dot French towns and cities has risen 6.3 percent, according to a study by Familles Rurales, a consumer lobby group. At larger retailers, baguette prices are up as much as 19 percent over the period.

As millers deplete the stocks of wheat they purchased before the latest bad crop, they'll have to start buying more expensive grain. Galloyer says speculators are driving prices up even higher than would be expected. At some point, he figures, supply and demand will balance out. "In April or May, prices [of wheat] will decrease," he says.

Some bakeries are forgoing increases. **Boulangerie Paul**, which sells its bread through more than 360 outlets in France and 130 stores abroad, doesn't plan to raise baguette prices, according to a spokeswoman who declined to be identified. Carrefour, France's largest retailer, declined to comment on whether it will raise prices this year in response to higher wheat costs.

The daily consumption of bread in France has dropped to 4.2 ounces from 32 ounces in 1900, according to the French millers' association. Still, bread remains an important indicator of the cost of living, says Philippe Chalmin, an economics professor at the University of Paris-Dauphine and an adviser to the government on food costs. "The image of France is of the beret, the baguette, and a bottle of red wine," Chalmin says. "It's a psychological indicator. It's what makes France France." Ⓑ

—Rudy Ruitenberg

The bottom line *The global surge in wheat prices will soon affect the price of a baguette, that fundamental symbol of France.*

Seven Days

Events of note in the week ahead

by Ira Boudway

31

Japan's housing starts

U.S. personal spending



▶ **ExxonMobil earnings:** Rising demand for oil and petrochemicals have boosted profits at the world's largest company by market cap. Analysts expect close to $99 billion in revenue for the quarter.

01

Germany's unemployment rate

Earnings from Aflac, Electronic Arts, Pfizer, Sysco, and UPS

▶ **U.S. auto sales:** Cash-for-clunkers caused a spike in the summer of 2009. Sales have been slowly climbing since. Surveyed economists expect this January to best the year-ago period by 17 percent.



02

ADP employment change

Earnings from News Corp., Time Warner, and Visa

▶ **Yum! Brands earnings:** The fast-food conglomerate recently announced plans to sell its Long John Silver's and A&W chains to focus on expansion in China.



03

Ben Bernanke speaks at the National Press Club



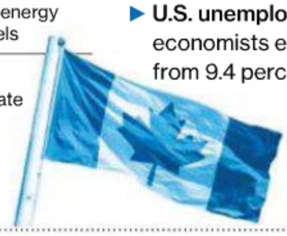
▶ **Merkel in Madrid:** The German Chancellor holds a joint Cabinet session with Spanish Prime Minister José Luis Rodríguez Zapatero.

▶ **Chinese New Year:** The Year of the Rabbit begins.

04

European Union energy summit in Brussels

Canada's unemployment rate



▶ **U.S. unemployment:** Surveyed economists expect the rate to rise from 9.4 percent to 9.5 percent.

05

GOP fundraiser timed to the 100th anniversary of Ronald Reagan's birth



▶ **Middle East quartet:** Hillary Clinton, Ban Ki-moon, Russian Foreign Minister Sergey Lavrov, and EU foreign policy chief Catherine Ashton meet in Munich to try to jump-start the Mideast peace process.

06

Super Bowl XLV



▶ **World Social Forum:** The annual counterpoint to the World Economic Forum in Davos begins in Dakar, Senegal.

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Companies&Industries

How Siemens Got Its *Geist* Back

▶ **Outsider CEO Peter Löscher took the German icon "green"**

▶ **"When I...got here, I felt I was in the Kremlin," says a newcomer**

Siemens Chief Executive Officer Peter Löscher still recalls the blank stares he received when he asked about the company's green strategy after his arrival three years ago. The former top executive at **General Electric** and **Merck** was brought in to clean house after a global bribery scandal almost toppled the German engineering giant.

Löscher knew that Siemens had world-class researchers and lots of promising products in the pipeline. However, the company was so traumatized by the bribery firestorm that it failed to see opportunities that could power Siemens' growth in the years ahead. Löscher's solution: "We very early focused on megatrends" such as green business to assure the company's future.

While jettisoning the telecommunications and information technology businesses, Löscher has increased the chunk of Siemens that sells sustainability-focused customers everything from light bulbs to high-speed trains to factory control systems. The Munich-based company today generates more than $38 billion in sales from wind power, solar energy, and energy-conserving electricity grids. Siemens also claims the lead in offshore wind turbines, a market that has doubled in size in just the past two years. And about one quarter of its roughly 400,000 employees today are what Siemens calls green-collar workers, those who produce or market its portfolio of resource-efficient products.

"Siemens is reaping the rewards from its restructuring but also from its prescient strategy," says Jutta Rosenbaum, an investment manager at insurer Allianz's Aequitas unit. "Siemens is very well positioned to achieve above-average growth."

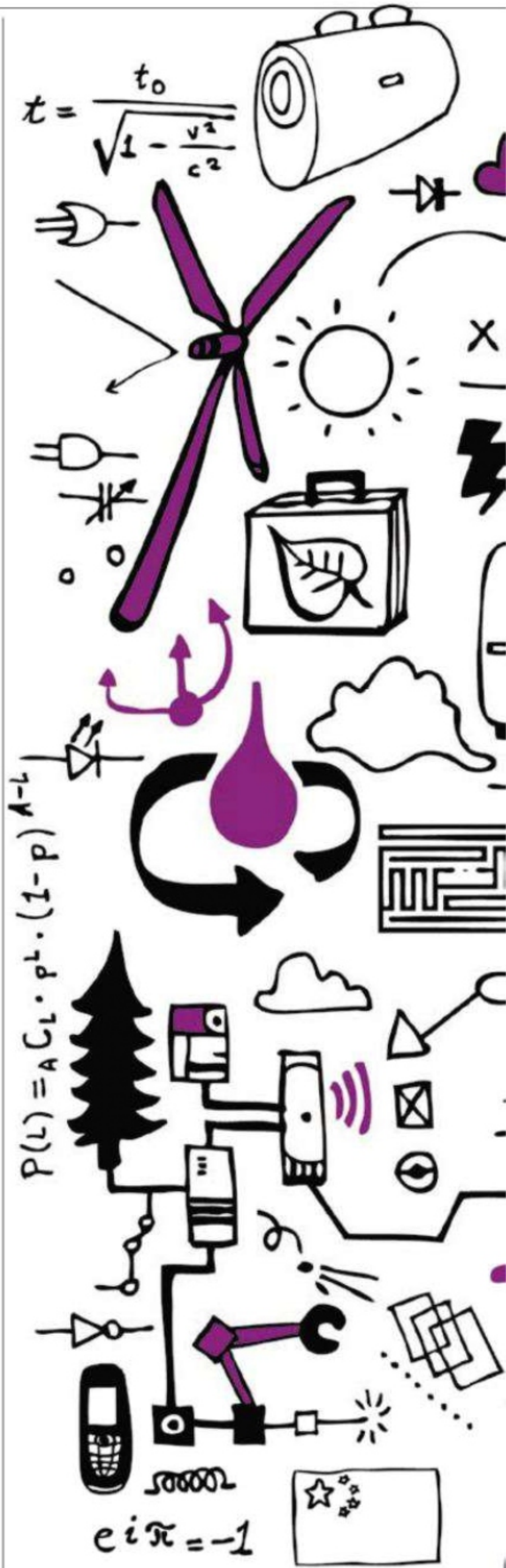
Today about a quarter of Siemens's employees produce or market resource-efficient products

The transformation has given a boost to Siemens' finances. Profits are at an all-time high, and shareholders are pocketing record dividends. Löscher, however, exhorts his team not to get cocky. "Being good today means you have to be better tomorrow, and even better the day after tomorrow," he says. "The biggest risk is complacency."

Figuring out how to better manage its success is a dramatic turnabout for Siemens, which five years ago became enmeshed in Germany's biggest corruption scandal since World War II. Securities regulators found that Siemens for years had paid bribes to win government infrastructure contracts in countries including Iraq and Russia. Although it has settled with U.S. regulators, the flap continues to dog the company: Greek Prime Minister George A. Papandreou on Jan. 25 said his country wants to seek damages from Siemens over past bribes to officials in Greece.

Even worse than the $2.5 billion in fines and fees slapped on Siemens so far, management feared that a weak response could result in governments barring it from receiving future contracts. So Siemens Chairman Gerhard Cromme was emboldened to cross the Atlantic to tap the first outsider to lead Siemens in its history. Löscher, an Austrian, was little known in Corporate Germany, he had considerable experience as a senior manager at GE, a big engineering-based organization similar to Siemens.

The choice of a former GE executive held particular significance for Siemens employees because of the historical connection between the two compa-



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nies. Thomas Edison traveled to Berlin in the late 19th century to see if Werner von Siemens would invest in his company, which later became known as General Electric. Siemens accepted and in part was responsible for getting GE off the ground.

Löscher wasted little time showing his tenure wouldn't be business as usual. A big mobile-phone business, once the company's most prized unit, was given away and eventually shuttered. And Siemens in December 2010 agreed to sell its cash-bleeding computer services unit to France's **Atos Origin**.

The new CEO hasn't been afraid to make equally wrenching changes to Siemens's management. He has replaced almost the company's entire executive suite, and even 50 percent of middle managers have been switched since his arrival. Löscher calls the bribery scandal "a catalytic event" for Siemens. "It would not have been possible to achieve what we achieved at this speed without this event, which made us question how to do things," he says. "In hindsight, it is an extremely positive caesura point."

That state of crisis also allowed Löscher to chip away at Siemens's inbred culture, adding to it some GE-style management discipline. "The one thing GE does better than anybody is execution," said Peter Y. Solmssen, who joined Löscher from GE to oversee the German company's compliance. "They set a target, and they achieve it. That's it." Solmssen says that kind of consistent, performance-based management wasn't the norm across Siemens. "Processes were incredibly formal," he said. "When I first got here, I felt I was in the Kremlin."

Löscher has moved quickly to do away with the German company's traditional fiefdoms. Gone are the days when country chiefs could singlehandedly buy a business, where divisional leaders had little accountability for their units' profitability, and where the CEO had to rely on the office grapevine for information. Löscher streamlined the portfolio of businesses, added managers with international experience, and held board meetings abroad to shake off the cobwebs of the stiff German conglomerate.

The transformation has positioned Siemens to go head-to-head

ILLUSTRATION BY BEN WEEKS; LÖSCHER: JASPER JAMES

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against rival GE. The two companies compete in health-care technology, power turbines, transportation, and eco-friendly energy generation.

A key part of Siemens's strategy, like that of GE, is a big bet that increasing green consciousness will fuel future sales. So far it seems to be working. Wind-energy sales in the most recent quarter surged 81 percent, to 868 million euros ($1.2 billion), the biggest increase among Siemens's divisions, the company said on Jan. 25. It built its wind-power business from scratch with the acquisition of Denmark's Bonus Energy in 2004, a business that has mushroomed tenfold into more than 7,000 employees since.

Another 2,000 jobs will be added this year, predicts René Umlauft, CEO of the renewable energy division at Siemens. GE and Denmark's **Vestas Wind Systems** are still the two largest makers of wind turbines. However, sixth-ranked Siemens has vowed to crack the top three by 2012. Promises Umlauft: "We are going to spend a lot of money."

Löscher doesn't even need words to explain his progress since coming on board. Asked what he has achieved since taking over at Siemens, he silently holds up a chart showing his company's stock performance vs. competitors. Siemens has surged 48 percent in a year, almost twice as much as GE's gain. **ABB**, run by another former GE veteran, Joseph M. Hogan, is even further behind, with a 17 percent gain.
—*Richard Weiss and Benedikt Kammel*

The bottom line *After a bribery scandal, Siemens has remade itself into a more disciplined company targeting "mega-trends" such as green business.*

Quoted

"The moral of the story is, listen to your mother."
—Tom Hooper, director of *The King's Speech*, on the genesis of his surprise hit. The filmmaker's mother attended a reading of an unproduced play about Queen Elizabeth's stammering dad and recommended it as her son's next film. It's been nominated for 12 Academy Awards.





$593 MILLION
What ArcelorMittal and a partner bid to acquire Baffinland

-58° FAHRENHEIT
Temperatures can fall this low, which would halt production



18 MILLION TONS
Projected production per year if a rail line can be built to transport ore

365 MILLION METRIC TONS
Amount of high-quality ore reserves at Mary River

Mining

An Iron Ore Rush Above the Arctic Circle

▶ As steel demand grows, Canada is the new resource battleground

▶ "There's nowhere else to go ... no rock left unturned in Australia"

Baffin Island in Canada's frigid Nunavut territory is about as far off the grid as most people can imagine. Subzero temperatures, ice-blocked sea lanes, and a lack of conventional infrastructure make this spot more than 300 miles above the Arctic Circle among the planet's most inhospitable places to do business. That hasn't stopped international mining companies from fighting over the remote turf. The attraction: huge iron ore deposits underneath a barren landscape—a reminder of just how far global mining companies will go to secure new reserves.

After oil, almost nothing is as central to the operation of a modern economy as steel. Everything from appliances to automobiles to skyscrapers depend on the stuff. That has made iron ore, steel's main component, a hot commodity amid the current global resources boom, especially for fast-growing emerging economies.

The price of iron ore has more than doubled in the past two years amid surging Chinese steel production. Most ore exports come from Brazil and Australia, where the world's three biggest mining companies, Brazil's **Vale** and Australia's **Rio Tinto Group** and **BHP Billiton**, dominate. That's left other mining companies, steel producers, and big users such as China to fight over the few remaining big iron fields, including desolate Baffin Island.

Luxembourg-based **ArcelorMittal**, the world's largest steelmaker, and **Nunavut Iron Ore Acquisition**, a company backed by Houston-based private equity firm **Energy & Minerals Group**, on Jan. 14 struck a C$590 million ($593 million) deal to jointly acquire **Baffinland Iron Mines,** whose Mary River project on the island may become the first iron-ore mine inside the Arctic Circle. The estimated cost of building the project, including an 87-mile railroad and a port that can be reached only by custom-built cargo ships able to navigate frozen seas, is more than $4 billion.

Other companies don't want to be left behind. Cleveland-based **Cliffs Natural Resources** in mid-January agreed to pay C$4.9 billion, including net debt, for Montreal-based **Consolidated Thompson Iron Mines** to lock up iron ore assets in northern Quebec. And Liu Yikang, chief of the Expert Group for Overseas Resources Proj-

CLOCKWISE FROM LEFT: DR. BILLY INGRAM/WIREIMAGE/GETTY IMAGES; MANDEL NGAN/AFP/GETTY IMAGES; IMAGINECHINA/AP

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Obama's go-to guy on jobs page 25 ▶



ects at China's Ministry of Land and Resources told Bloomberg News in mid-January that a Chinese company was involved in the bidding for Baffinland, though he declined to name it.

"There's nowhere else to go," explains Benjamin J. Cox, the founder of Portland (Ore.)-based research company Oren and chief executive officer of Canadian iron-ore mine developer **Roche Bay**. "There's no rock left unturned in Australia, and anything that's nice in Africa already is controlled."

Baffinland has so far spent almost $500 million evaluating Mary River. To get ore to the coast, Baffinland CEO Richard D. McCloskey says four rivers must be crossed. The company has resorted to using temporary bridges made from shipping containers welded together so rock samples can be moved by truck. Workers also must contend with temperatures that sometimes dip below -50C (-58F). At such temperatures, "steel starts breaking, fuel starts freezing," McCloskey says.

To guarantee deliveries, Mary River will need ice-breaking, bulk-commodity-carrying ships with three times the normal engine power, says Tim Keane, Arctic operations manager for Montreal-based shipper **Fednav**. Such vessels have never been built and, according to Keane, may cost up to twice the price of conventional vessels. "Ordinary ships don't have the horsepower required to muscle their way through those conditions," he explains.

Mary River has an estimated 365 million tons of reserves in its first deposit (eight others have been discovered so far), based on ore being transported by rail. Production could surpass 18 million tons a year on that basis. That would cause Canadian ore output, which the U.S. Geological Survey pegged at 27 million tons in 2009, to soar. Even so, it would be dwarfed by Brazil's 380 million tons and Australia's 370 million tons of annual production.

Asian steelmakers are already involved in Canadian iron ore. **Tata Steel**, India's biggest producer, has a joint venture with Canada's **New Millennium Capital** to mine in the provinces of Quebec, Newfoundland, and Labrador. China's **Wuhan Iron and Steel**, the world's fifth-biggest steelmaker, owns 19 percent of Consolidated Thompson and has agreed with **Adriana Resources** of Vancouver to develop the Lac Otelnuk iron-ore project in Quebec.

"There's a feeling in China that the Big Three have taken advantage of China in the past and that's something they want to avoid in the future," says Adriana CEO Allen J. Palmiere, referring to the dominance of Vale, Rio, and BHP.

ArcelorMittal, meanwhile, is reducing its reliance on third-party suppliers by raising its mining capacity. The company said in September it planned to spend $4 billion to increase output to 100 million tons by 2015.

Even before ArcelorMittal's initial bid in November, Baffinland had already attracted other steelmakers' attention. Germany's **ThyssenKrupp** and **Voestalpine** reached accords to buy some future output from the Baffin Island field, and **Mitsubishi** agreed to buy up to 1 million tons a year to sell in Japan and Taiwan. Notes Gordon A. McCreary, chairman of Toronto-based explorer **Asia Now Resources** and a former CEO of Baffinland: "Huge things are going on in the North." —*Natalie Doss*

The bottom line *The world's appetite for iron ore, used in steelmaking, has sparked interest in mining reserves in Canada's desolate Arctic Circle region.*

Entertainment

Imax's Widescreen Profit Performance



▶ With interest in effects-laden films up, the large-screen exhibitor soars

▶ "The real benefit is that it's immersive and massive"

Lots of companies have rebounded from the recession, but few have regained form as quickly as the larger-than-life theater company **Imax**. Box-office sales for films shown on its mega-screens more than tripled over the past two years, to $587 million in 2010. (Imax pockets as much as a third of each ticket's cost.) Shares have risen tenfold since late November 2008. By the end of this year, Imax projects it will have about 600 screens, up from 266 in 2005. That could mean more prosperous times ahead, since Imax says its screens generate nearly five times the revenue of those at a traditional cinema.

There's also the cool factor: Imax's giant curved screens, once best known for showing feel-good nature films at museums, have become among the hottest dates in Hollywood: Top directors such as James Cameron and J.J. Abrams fight to open their special-effects-laden hits at Imax venues to crank up the wow factor. "The benefits to the studio, I'm sure, involve higher ticket prices and having another kind of aspect to publicize. But the real benefit is that it's immersive and massive," says Abrams, who is producing the next installment of **Viacom**'s *Mission: Impossible* franchise for an Imax release.

Despite such accolades and the current popularity of Imax's widescreen fare, executives say the company almost failed before plotting a difficult digital rebirth. "We came very close to the financial brink" a decade ago, recalls Chief Executive Officer Richard Gelfond. "We discussed bankruptcy and a recapitalization. For an extended period of time we managed for cash, not growth, and beyond that we had to change the company–just about everything."

Crippled by debt, high costs, and clunky analog technology, Imax twice tried to find a buyer, most recently in 2006. Yet potential suitors doubted the company's ability to move beyond traditional low-return mainstays such as *Whales: An Unforgettable Journey*, and Imax failed to drum up interest.

The repeated failures turned out, in hindsight, to have been a lucky break, since they forced Gelfond to undertake a transformation that fundamentally altered nearly every aspect of Imax's business model. One key issue: how to convert Hollywood's 35mm films to Imax's 70mm format. Gelfond says Imax, unable to find anyone with technology to blow up the movies without distortion, had to invent its own process. Imax now has 105 patents, with 72 more pending.

"They are really a pretty simple story of a company with a concept

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that was 15 years too early," says Michael Pachter, a Wedbush Securities analyst. "They started to build out their theaters before they had the right content ready, the Hollywood movies. Now they have ... become the Louis Vuitton of theaters."

A financial restructuring was another critical advance. In 2008 the company penned a deal with theater operators that required far less capital up front from Imax and produced revenues quickly, followed the next year by $131 million in equity offerings. The fresh capital plus short-term borrowings were used to retire all long-term debt.

Tech advances also have helped. Imax's old large-format film reels, which cost up to $40,000 per copy and weighed hundreds of pounds, have been replaced with hard drives that cost a few hundred dollars and offer better-quality digital video. And the cost of building large-format theaters or retrofitting multiplexes with Imax systems has fallen from about $7 million to a few hundred thousand dollars, thanks to lower construction costs and less expensive gear.

Moviemakers say Imax can help lift a film above the weekend multiplex clutter. "What creates the buzz for a movie is when somebody walks out of an Imax theater Tweeting and Facebooking, saying, 'You should see what I just saw,'" says Jon Landau, James Cameron's producing partner on *Avatar* and a coming sequel. "That's what we're going for."

Imax's first clear sign of mainstream success was with *The Matrix Reloaded* in 2003, the first time Imax showed a movie simultaneously with regular theaters. "I was looking to do something out of the box; to make our film special," says Dan Fellman, head of domestic distribution at **Time Warner**'s Warner Bros. Entertainment, the studio behind the movie. "Whether or not I broke even wasn't the question." The movie grossed $742 million, up from $464 million for the original *The Matrix*. Although the Imax box-office take was just $14 million, it was enough to prove the format's credibility to Hollywood. It's a different story today: Imax showings generated $242 million of *Avatar*'s $2.78 billion worldwide box office and almost one-quarter of the ticket sales for *Tron: Legacy* on just 2 percent of the screens showing the film, according to Imax.

The trick now, Gelfond says, is to leverage the Imax brand without diluting it. The company is forming **3d Net**, a cable channel with **Sony** and **Discovery Communications**, and has built a prototype portable Imax theater that could show movies or even live events such as rock concerts at temporary locations. Says Greg Foster, Imax's chairman of filmed entertainment: "If we can provide a piece of our DNA that creates a better experience, then it might make sense to try something new."

—*James Sterngold and Michael White*

The bottom line *Widescreen theater operator Imax, once barely afloat, is riding the current wave of popularity for 3D and special-effects films.*

54.9

MILLION

The number of television viewers who watched the Pittsburgh Steelers defeat the New York Jets on Jan. 23 for a spot in the Super Bowl. It was the most watched American Football Conference championship ever.

DATA: CBS SPORTS

Hamburger U. is tougher to get into than Harvard



THIS PAGE, CLOCKWISE FROM TOP LEFT: AP PHOTO; QILAI SHEN/BLOOMBERG (3). OPPOSITE PAGE, CLOCKWISE FROM TOP: MIKE KEMP/GETTY IMAGES; CHARLES CORMANY/GETTY IMAGES; CHROME LOGO: PAUL SAKUMA/AP; MASK: TIMOTHY HUGHES/GETTY IMAGES

Fast Food

East Meets West at Hamburger University

▶ **McDonald's indoctrinates Chinese managers at its Shanghai center**

▶ **"We'll make sure the people pipeline is ready"**

Zhou Xiaobu runs from one end of a table to another, grasping a piece of a jigsaw puzzle her team is assembling as part of a leadership training exercise for **McDonald's** managers. "Go, go, go!" yells their instructor, exhorting them to work for the prize, a box of Danish butter cookies that will go to the first group to build the company's trademark Golden Arches. Above their heads a sign reads: "Learning today, leading tomorrow." The thick green binders stuffed with paperwork on each of the 31 students' desks indicate this is no place for slackers.

Such is the seriousness of purpose found at McDonald's new Hamburger University near Shanghai, where the chain aims to crank out a new generation of leaders to fuel big expansion plans in China. While the 20th-floor training center is no Harvard, landing a spot at the Chinese campus of Hamburger U. (McDonald's has seven worldwide) is actually more difficult than getting into the Ivy League icon. (Less than 1 percent of McDonald's applicants get in, making Harvard's 7 percent acceptance rate look downright welcoming.)

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Zhou was one of only eight people hired from among 1,000 applicants for a management trainee position in the central Chinese city of Changsha. She then had to compete with 43 other workers at her store to be named first assistant manager, earning her a slot at Hamburger U.

Getting into the school is so competitive because more than 26 percent of China's 6.3 million college graduates were unemployed as of July 1, compared with a 4.2 percent jobless rate for its urban workforce. That has caused grads who wouldn't normally consider a food-service career to give Mickey D's a look. "The main reason McDonald's put up Hamburger University is to professionalize the sector, making it easier to recruit better people," says Joel Silverstein, president of Hong Kong-based consultants East West Hospitality Group.

McDonald's is counting on students schooled in store operations, leadership, and staff management at the Shanghai campus to power its mainland growth. So far it's been outpaced by rival **Yum! Brands**, parent of KFC and Pizza Hut. McDonald's operates 1,300 stores in China and aims to have 2,000 by 2013. Yum already has 3,700 in China, where it earned 44 percent of its $1.33 billion operating income in the first three quarters of 2010. An approving Wall Street sent Yum's market value up 40 percent last year, vs. McDonald's 23 percent.

McDonald's plans to raise investment in China by 40 percent this year after boosting such spending by 25 percent in 2010. It opened a record 165 outlets in China last year and plans 1,000 more by the end of 2013. Analysts say the chain can't meet that goal without minting more local managers to run individual stores and chart regional strategy. "They are preparing a base that will allow them to accelerate that rate of expansion," says Peter Jankovskis, co-chief investment officer of OakBrook Investments.

Hamburger U., which will cost McDonald's 150 million yuan ($22.8 million) in the five years through 2014, trained 1,000 of McDonald's almost 70,000 Chinese employees last year, says Susanna Li, its head. An additional 4,000 will attend classes through 2014. "We'll make sure the people pipeline is ready," she says. —*Michael Wei*

The bottom line *McDonald's has big growth plans in China. It has opened a Hamburger University campus there to train managers to run those new stores.*

Briefs

by Caroline Winter



Pfizer
Partnering with universities

The National Institutes of Health is pressing drugmakers to follow Pfizer's lead and let government-backed scientists experiment with chemical compounds the companies failed to turn into drugs. Pfizer agreed last May to pay Washington University in St. Louis $22.5 million to find new applications for its discarded molecules. The pharmaceutical giant has signed similar agreements, worth up to $100 million, with seven New York medical schools. Pfizer will share intellectual property rights and revenues with the schools on a case-by-case basis. NIH Director Francis Collins says he eventually hopes to steer his agency into similar partnerships.

Google
Offering a little more privacy



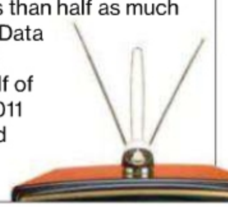
Google on Jan. 24 released a tool that lets users of its Chrome Web browser stop advertisers from monitoring their Web-surfing habits. The tool, called Keep My Opt-Outs, only blocks ad tracking by companies that offer opt-outs through industry self-regulation programs. Microsoft and Mozilla also plan to add anti-monitoring features to their browsers. The Federal Trade Commission issued a report last year calling for a do-not-track option, in response to consumer concerns about privacy.

Toyota
Another global recall

Toyota on Jan. 26 recalled about 1.7 million vehicles globally for defects in fuel lines and pressure sensors, and spare tire carriers. The recalls include 1.28 million Voxy, Noah, and Isis minivans and RAV4 sport-utility vehicles in Japan, 245,000 Lexus luxury cars in the U.S., and 135,000 Avensis sedans in Europe. Since September 2009, Toyota has also recalled over 8 million cars with defects linked to unintended acceleration. Last year, Toyota was the only large automaker to post a sales decline in the U.S., historically its most profitable market.

Nielsen
A record private-equity IPO

Nielsen, the television audience rating company owned by Blackstone Group, Carlyle Group, KKR, and Thomas H. Lee Partners, raised $1.6 billion in the biggest private equity-led U.S. initial public offering since 2006. The sum exceeded expectations for a company that posted $1.4 billion in net annual losses since being taken private four years ago, especially since IPOs backed by private equity funds gained less than half as much as other IPOs last year. Data compiled by Bloomberg show that more than half of U.S. IPOs planned for 2011 are backed by leveraged buyout firms.



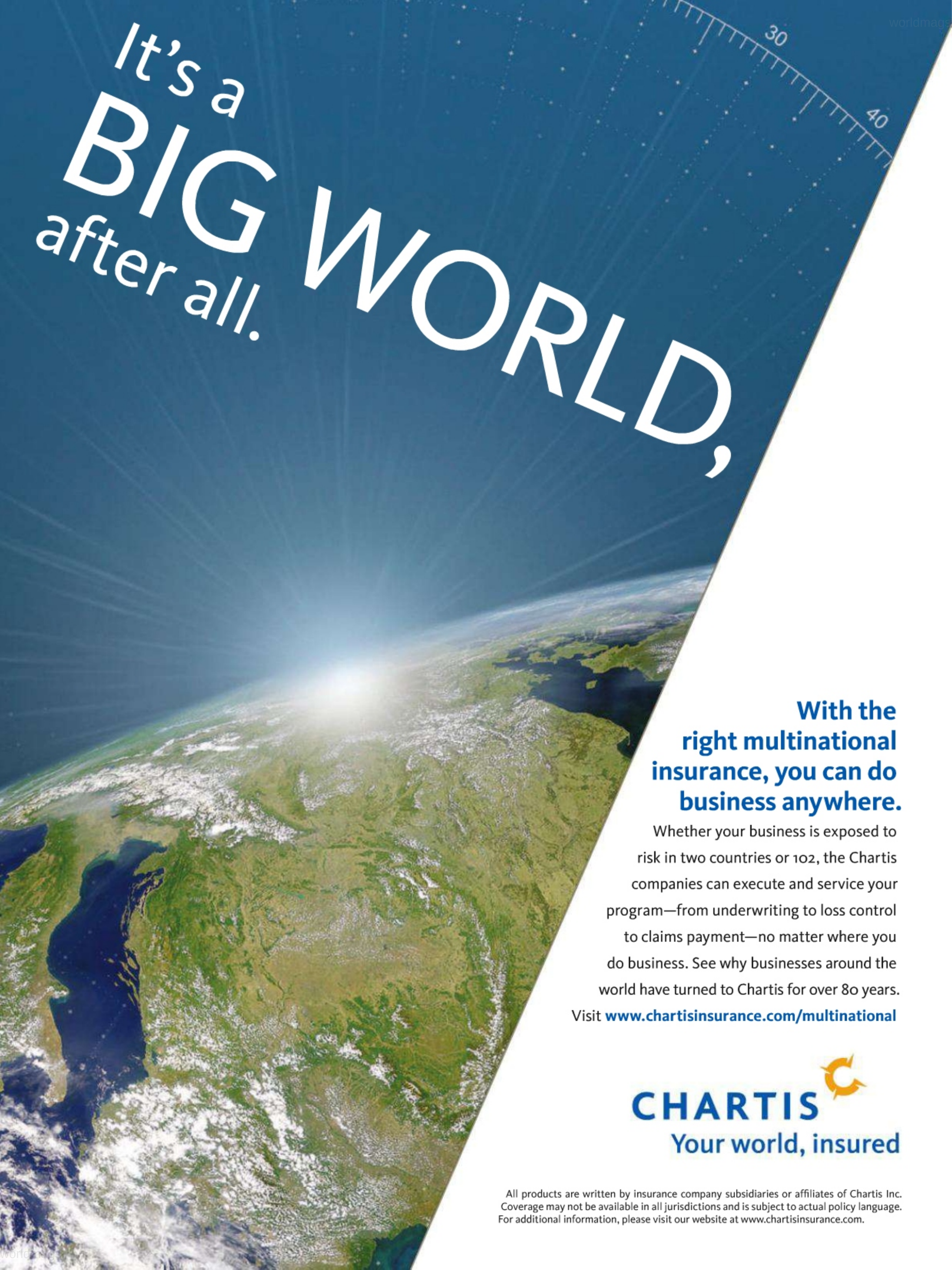
Barclays
A thousand jobs on the line

Barclays may cut about 1,000 jobs at its U.K. consumer unit as it ceases offering individual customers face-to-face investment advice at its branches. The bank, which has about 147,000 employees worldwide, is reviewing its divisions to focus on operations that deliver the greatest returns. CEO Robert Diamond says the lender plans to rein in costs by providing retail investment services solely online. The potential job cuts won't affect clients of Barclays Wealth, the lender's private banking unit. According to the Confederation of British Industry, U.K. financial services companies will eliminate an estimated 45,000 jobs between September 2010 and March 2011.

On the Move

CVS Caremark COO Larry Merlo named CEO • RadioShack CFO Jim Gooch will step up to CEO in May • Merck Lanxess CFO Matthias Zachert to be CFO • Intel Black Eyed Peas popstar will.i.am hired as a creative director

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It's a
BIG WORLD,
after all.
30
40
With the right multinational insurance, you can do business anywhere.
Whether your business is exposed to risk in two countries or 102, the Chartis companies can execute and service your program—from underwriting to loss control to claims payment—no matter where you do business. See why businesses around the world have turned to Chartis for over 80 years.
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All products are written by insurance company subsidiaries or affiliates of Chartis Inc. Coverage may not be available in all jurisdictions and is subject to actual policy language. For additional information, please visit our website at www.chartisinsurance.com.

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Obama
"We think GE has something to teach businesses all across America"

100,000
Number of math, science, and engineering teachers Obama wants U.S. schools to produce in 10 years

Immelt
"I'm honored to be able to work on something that has importance in a broader economic context"

$150bn
GE's worldwide sales in 2010. More than half were from outside the U.S.



MANDEL NGAN/AFP/GETTY IMAGES

Good for GE, Good for America?

▶ The interests of Obama and Immelt—the GE chief and new jobs adviser—increasingly overlap

▶ Says one fund manager: "This appointment simply can't be bad for GE"

Jeffrey R. Immelt might have expected some blowback. With unemployment still high and a charged political atmosphere in Washington, anyone asked to chair a new President's Council on Jobs and Competitiveness was likely to face scrutiny. Sure enough, when President Barack Obama named the chief executive officer of **General Electric** as his choice on Jan. 21, Immelt was labeled a crony capitalist by the right and a destroyer of American jobs by the left for his decision to close plants in the U.S. in recent years. Others wondered how he would dispassionately manage his new role while running a $150 billion-a-year company under enormous pressure from Wall Street.

From the Oval Office, the answer is clear: What's good for GE is good for America. The company, says White House senior adviser Valerie B. Jarrett, "is competing in a global marketplace, and it is winning. It's moving jobs back to America, it's exporting goods all over the world, and that's really the model that we think is ideal."

The Immelt courtship start-

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Obama's and GE's strategies are in sync

Clean Energy

25 THOUSAND
Number of electric cars GE will have by 2015

Both advocate a cap-and-trade system that would make it more expensive to emit greenhouse gases, creating incentives to switch to renewable energy sources. For GE, that could boost sales of products like low-emission turbines, devices to recharge electric vehicles, solar panels, and "smart" electric meters.

80%
Percentage of electricity coming from clean sources by 2035, says Obama

Infrastructure

Jet engines
Locomotives
Gas turbines
Water treatment

Each has made infrastructure the clarion call for creating jobs. For Obama, the focus is on rebuilding roads, bridges, and mass transit, along with upgrading the power grid. That's a boon for GE, which gets more than half its total sales from infrastructure businesses.

2036
Year by which Obama wants 80% of Americans to have access to high-speed rail

Research and Development

2,789
Staff at global research centers

Obama and Immelt have talked about the need for more and better-trained U.S. engineers and scientists. Immelt has doubled GE's research budget over two years to $6 billion, beefing up centers in New York, Shanghai, Munich, and Bangalore. Next: Brazil.

$8.5 BILLION
Estimated tax credits claimed by companies for R&D spending in 2008

Health Care

10%
Projected annual profit growth for GE Healthcare through 2015

Both have called for more affordable and efficient health care, in part through a rapid transition to electronic health records. That could be a windfall for the information technology arm of GE's $17 billion-a-year health-care business.

$27 BILLION
Expected bonuses the U.S. will pay providers to adopt electronic health records by 2021

ed during Obama's Asia trip in November. At a meeting in India, Immelt had a chance to see the President advocate for U.S. companies, while Obama got a closer view of GE's success in selling big-ticket products abroad. More than half of GE's sales and its 304,000-strong workforce are outside the U.S., and the company rang up $17 billion in exports from its stateside operations last year.

Obama called Immelt, 54, from Hawaii during his Christmas vacation and asked him to take the helm of the new council. After running the idea by GE's board, Immelt called the President back a few days later to accept.

To some investors, taking the role is practically a fiduciary duty. Stephen Hoedt, a Cleveland-based analyst for Key Private Bank, whose parent company owns 17 million GE shares, says Immelt may be "able to affect policy at the highest level." Brian James, co-head of research at fund manager Loomis Sayles, says he hopes Immelt, a Republican, gets "some insights into what's going to impact GE coming out from Washington," adding "this appointment simply can't be bad for GE."

Just how much access—and success—Immelt will see is an open question. Fostering job growth is a challenge that has confounded the brightest minds. Immelt has agreed to chair an advisory group that may not wield much influence. The panel it replaces—the President's Economic Recovery Advisory Board, on which Immelt also served—met with Obama four times during its two-year lifespan. The new council is scheduled to meet with the President once a quarter.

For GE, there could be many side benefits. The interests of Immelt and Obama increasingly overlap. Immelt needs the right policies in place to drive growth in areas such as infrastructure, cleantech, health care, and finance. Sales of wind turbines and solar panels are tied to U.S. energy policy and emissions standards. Decisions over whether to upgrade the power grid, invest in high-speed rail, buy jet engines, or modernize hospital systems are often made at a political level.

What Obama does or says on the world stage is of great interest to a company that needs open borders and political goodwill to thrive. As Gwen Ruta, who heads the Environmental Defense Fund's Corporate Partnerships program, says: "It's a short hop from his thinking about GE's strategy to where the jobs are going to be."

Advising the President on job creation could prove fruitful for GE in other ways. Immelt's mandate touches on a host of issues important to a company that spent $39.3 million last year lobbying Washington, more than any other corporation, according to the Center for Responsive Politics. In a Jan. 21 call to discuss fourth-quarter earnings, Immelt said he'd focus on such areas as competitiveness in jobs, exports, global tax policy, regulations, and manufacturing. "I'm honored to be able to work on something that has importance in a broader economic context," he said. While he must keep GE's business and the council legally separate, stronger bonds might not hurt when GE is battling the Administration on issues such as continued funding for an alternative engine for **Lockheed Martin**'s Joint Strike Fighter.

Although critics such as Representative Marsha Blackburn (R-Tenn.) may disagree with the decision to have Immelt lead the council—she argues a small business owner or entrepreneur "may have been a better fit"—the GE chief certainly shares Obama's focus on job growth through green technology, infrastructure spending, and increased efficiencies in health care. "People want to see business and government

PHOTO ILLUSTRATION BY EMILY KEEGIN; PHOTOGRAPHS: BLOOMBERG(1); ALAMY(3); GETTY IMAGES(2); NATIONAL AIR AND SPACE MUSEUM/2006-25302(2)

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work together, both in the U.S. and globally, to drive innovation, employment, and growth," Immelt wrote in a 2009 letter to shareholders. In the last two years, GE has announced plans to add some 6,500 manufacturing jobs in the U.S.

In some ways, Immelt is starting to sound like a politician himself. Whether in speeches or op-ed pieces, he talks about the need for a national policy to create jobs from exports. Immelt has more time to spend in Washington—when not calling on other government leaders—after moving Vice-Chairman John Rice to Hong Kong in early January to lead GE's global operations. Given the uncertainty in GE's home market, not to mention opportunities to participate in earmarked projects and policy debates, Sterne Agee analyst Nick Heymann argues, Washington is a good place for Immelt to be. "This is where the opportunites to influence are," he says. *—Diane Brady and Rachel Layne, with Julianna Goldman, Lisa Lerer, and Jonathan D. Salant*

The bottom line: *With its focus on infrastructure and cleantech, Immelt's blueprint for jobs dovetails with Obama's policy agenda.*

Education

Obama's Reform Plan Relies on Big Business

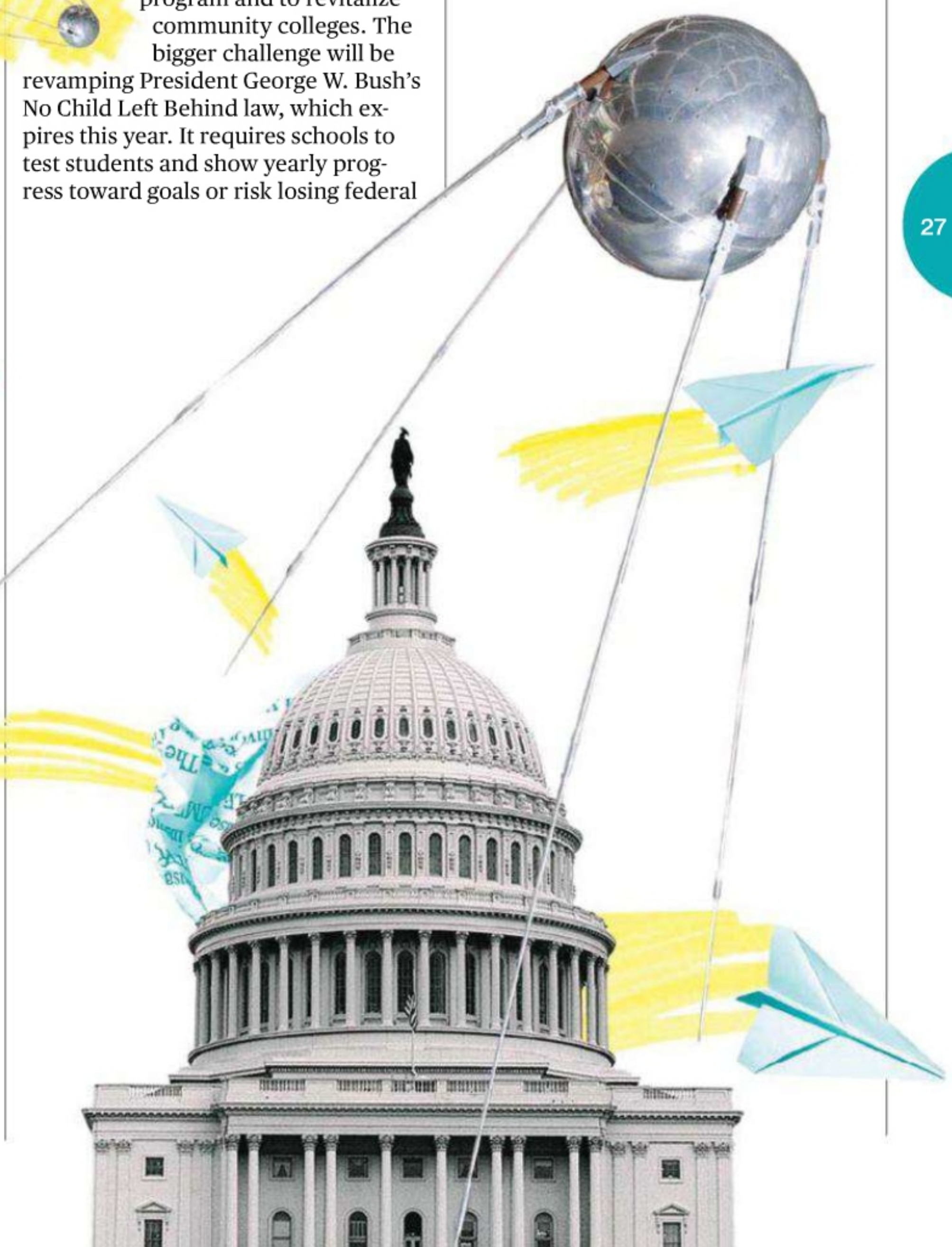
- **He needs companies to help him fend off deep budget cuts**
- **Education Secretary Duncan will "provide a lot more flexibility"**

To help the U.S. compete with emerging economies such as China and India, President Barack Obama pitched Congress on a renewed focus on education in his Jan. 25 State of the Union message. "This is our generation's Sputnik moment," he said, invoking the U.S. response to the Soviet Union's 1957 launch of the first satellite. That feat, at the height of the Cold War, jarred American assumptions of technological superiority.

With a divided Congress and House Republicans gunning for the Education Dept., Obama's school reform plans may depend largely on Big Business. Administration officials say they have had more than 30 meetings and phone calls over the last year with executives about school overhaul. Penny Pritzker, who led Obama's 2008 campaign fundraising effort and is chairman of **Pritzker Realty Group** in Chicago, says she's "sure that business leaders will be asked to go to Capitol Hill to make the argument" for an improved public education system. Jeffrey R. Immelt, the **General Electric** chief executive officer, agrees education should be a part of his portfolio as head of Obama's new jobs and competitiveness council, Pritzker says.

Obama is proposing to make permanent a tuition tax credit program and to revitalize community colleges. The bigger challenge will be revamping President George W. Bush's No Child Left Behind law, which expires this year. It requires schools to test students and show yearly progress toward goals or risk losing federal money. Obama wants to give schools more flexibility in demonstrating academic progress, reserving the harshest sanctions, including firing teachers, for schools in the bottom 5 percent in achievement. He also wants to give school districts the power to apply directly to Education Secretary Arne Duncan's Race to the Top program, which enables states with innovative programs to compete for federal funds.

Republicans have other ideas. John Kline (R-Minn.), the new chairman of the House Education & the Workforce Committee, said in a statement that his goal is to "pull back federal involvement in the day-to-day operation of our classrooms." More than half of the



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Unrest in the Streets Of Cairo *On Jan. 26, Egypt banned protests and tightened security following riots against the regime of President Hosni Mubarak. The U.S. called on Cairo to show restraint and allow the demonstrations. Tunisia's leadership was recently toppled by a popular uprising. Mubarak, too, may be vulnerable. He is 82 and has no clear successor. Unemployment in Egypt is running at 9 percent despite 5.3 percent economic growth last year.*

22 Republicans on Kline's committee are members of the Tea Party Caucus or were endorsed by conservative groups such as FreedomWorks and the Tea Party Express. Committee member Tim Walberg (R-Mich.) has said he sees "no place for the federal government in education." The total Education Dept. budget is just under $47 billion, not counting about $17 billion in Pell grants.

Duncan says he intends to "provide a lot more flexibility" by letting teachers and principals "figure out how to hit that higher bar, hold them accountable for results but give them the room to move." He says he's optimistic, adding that he's spoken to House Speaker John Boehner "numerous times" and to "almost every single new member."

From the opposite side, the National Education Assn. and the American Federation of Teachers (AFT), which together represent about 4.6 million educators, are unhappy with Obama's support for charter schools and merit pay for teachers. "There's no track record for simply saying that if you have a couple of charter schools, the other schools will get better because of the competition," says Randi Weingarten, president of the AFT. "There's no track record for paying a couple of teachers more and then thinking it's going to turn everything around."

Failure to refashion the No Child law would put more schools at risk of being labeled failures, says George Miller (D-Calif.), the House Democratic leader on education issues. "More and more schools are going to bump up against the requirements" that they're not going to be able to meet, he says. About one-third of U.S. schools are considered failures under the law's guidelines, according to Jack Jennings, president of the Center on Education Policy, a Washington-based group that advocates for public education.

Amid the turmoil and clashing agendas, corporate executives' perceived pull with Republicans could be the White House's trump card on education. "Wherever I can have the biggest impact, be it at a hearing or whatever in Washington, I'll make every effort to be there," says **State Farm Insurance** Chairman and CEO Edward B. Rust. Obama's very public attempts to make amends with business may help assure that Rust and his counterparts follow through on that pledge. —*Kate Andersen Brower*

The bottom line *Obama wants business to help him hold the center and fight off Tea Party and union efforts to block education reform.*

Entitlements

Social Security Gets A Reprieve—for Now

- **Backers had geared up for a fight with the President over benefit cuts**
- **"There's a battle going on for [Obama's] heart and soul"**

Of the big government programs, Social Security is the most obvious candidate for President Barack Obama's reformist agenda. The President, however, mentioned the pension program only fleetingly in his Jan. 25 State of the Union

FROM TOP: SCOTT NELSON/THE NEW YORK TIMES/REDUX; J. SCOTT APPLEWHITE/AP PHOTO

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address. "To put us on solid ground," Obama said, we should "find a bipartisan solution to strengthen Social Security for future generations." He stopped short of proposing benefit cuts, signaling that while he wants to fix a long-term funding shortfall, he won't be doing so this year.

That's some relief for defenders of the retirement program, who had been strapping on the armor for a fight with Obama over an increase in the retirement age or other steps aimed at assuring Social Security's solvency.

The struggle over the New Deal-era pillar probably isn't over. While Obama didn't call for sacrifice, nor did he repeat his 2008 campaign rhetoric that it is neither "necessary or fair to hard-working seniors to raise the retirement age." That omission has activists girding for a clash as the President's reelection campaign shifts into high gear. "There's a battle going on for his heart and soul," says Nancy J. Altman, an advocate for preserving Social Security who served as a senior aide on President Ronald Reagan's Social Security Commission. "You have to say, 'This is a sacred trust, and we can't break it.' "

Advocates for entitlement programs went on high alert after the President forged a tax-cut compromise late last year that included a $110 billion, one-year holiday on payroll taxes that fund Social Security. The groups include some core Democratic constituencies—and they aren't standing down, says Eric Kingson, co-director of Social Security Works and of the Strengthen Social Security campaign. He says more than 250 organizations, including the AFL-CIO and the Service Employees International Union, stand ready to fight any benefits cut. Barbara B. Kennelly, president of the National Committee to Preserve Social Security and Medicare, says her group gathered 780,000 petition signatures against shrinking benefits.



Such fears stem from the realization that Obama has a stronger hand to overhaul the program than either of his predecessors. He has surrounded himself with veterans of President Bill Clinton's reform effort, including Gene Sperling (left), Obama's new chief economic adviser, and budget director Jack Lew. A bipartisan commission Obama empaneled has recommended raising the retirement age to 69 by 2075. And midterm elections in November brought dozens of new Republican lawmakers to Washington with a mandate to cut spending. The public may be open to change, too, at least in principle: Polls show addressing the nation's $14 trillion debt ranks just below jobs as the top priority for Americans.

For all that, the President is battling the same headwinds that forced Clinton and President George W. Bush to forgo reform attempts until their second term. While the public may deplore the ballooning deficit, polls also show most Americans reject the changes Obama's commission said would be required to fix Social Security. A survey released on Jan. 18 by Greenberg Quinlan Roser Research, a Washington-based Democratic polling firm, found that 55 percent of respondents oppose raising the retirement age to 69—a proposal that the Senate's second-ranking Democrat, Dick Durbin of Illinois, said was "hardly radical." An additional hurdle: Unlike the last time Congress cut benefits and raised taxes, in 1983 under President Ronald Reagan, Obama can't argue the program faces an immediate funding crisis. While Social Security faces a long-term shortfall, the trust fund does not run out until 2037, according to a 2010 trustees report. —*Heidi Przybyla*

The bottom line *Obama may put off Social Security reform until a hoped-for second term, unless Republicans take the initiative.*

Transportation

Stuck on the Tarmac: Satellite Navigation

▶ The FAA may seek more outside aid to speed up implementation

▶ "The firepower is not in-house. Help is needed"

For years, airlines have been frustrated with the U.S. government's slow progress in adopting a satellite-based navigation system for landings and takeoffs. Ground-based instruments aren't reliable in foul weather, causing

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Silicon Valley's temple to technology page 35 ▶

flight delays and diversions that waste fuel. To hasten the switch-over, the Federal Aviation Administration in 2007 enlisted the private sector's help.

So far, the FAA has designed only 251 satellite-based procedures (step-by-step instructions about a flight path, much like the directions a driver gets from a car GPS system), now available to all carriers, and **Boeing** and **General Electric** have designed two. Thousands of routes need to be covered if all commercial airports are to switch to satellite navigation. Only 74 of the 450 U.S. commercial airports have satellite-guided systems in place.

Now the FAA in a report due on Feb. 1 is expected to advocate speeding things up by relying even more on private companies. "The firepower is not in-house. Help is needed," says William Voss, chief executive officer of the nonprofit Flight Safety Foundation in Alexandria, Va. FAA spokesman Paul Takemoto declined comment on plans for the vendors ahead of the report.

Why the holdup? The Transportation Dept.'s inspector general faulted the FAA in December for failing to spell out a clear role for the companies. That report also said divisions within the agency had slowed progress on a plan to monitor the companies' work. Without such an oversight plan, the union that represents 300 FAA workers who craft the navigation procedures says it opposes broader use of the vendors, out of safety concerns. The FAA, too, wants to make sure controllers and pilots have enough time to become familiar with the more complex satellite procedures.

Advocates say the new navigation technology is safe and cost-effective. An airline with 30 single-aisle planes flying the more direct routes might save $3.8 million a year in jet fuel, based on a $2.20-per-gallon cost, according to GE Aviation. With 3,554 narrowbodies in service in the U.S., according to the London consulting firm Ascend Worldwide, carriers could save up to $450 million annually. "It's all about the time value of money," says Steve Fulton, who helped develop the technology as a co-founder of Naverus, which GE acquired in 2009.

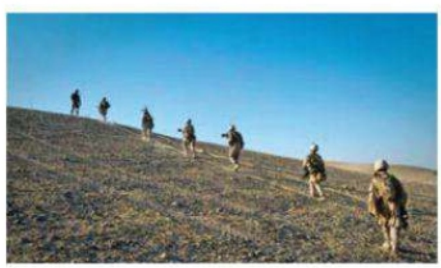
Seattle-based **Alaska Airlines**, which in 1996 became the first airline to use satellite navigation, flew almost 12,000 approaches and departures in 2010. Flights took off or landed 1,500 times with a satellite guidance system in tough weather without delays or cancellations. Atlanta-based **Delta Air Lines**, the world's second-largest carrier, has the technology available at more than 50 airports, says Grady Boyce, a technical pilot for the carrier. The technology also helped Delta eliminate flight diversions at Quito, Ecuador, an airport essentially carved out of a bowl in the mountains, he says.

GE and Boeing are participating to speed up the conversion. They hope to sell more airplanes and jet engines, which won't happen unless air congestion is relieved, says Dan Elwell, vice-president of civil aviation for the Aerospace Industries Assn., a trade group. Otherwise, "we'll just hit gridlock," says Elwell. —*John Hughes*

The bottom line *The FAA may soon ask outside companies to help speed up adoption of a next-generation satellite navigation system.*

Defense

A Peace Dividend From Troop Withdrawals



▸ Obama's war budget is said to tumble 26 percent

▸ "The largest year-to-year decrease in total war funding" since 2001

If President Barack Obama follows through on his plans to reduce the number of U.S. troops in Iraq and Afghanistan this year, he will get a small peace dividend that could alleviate pressure elsewhere on the federal balance sheet. Obama will propose cutting the Pentagon's war budget by $42 billion–a 26 percent decrease from this year's level–when he sends his next budget to Congress the week of Feb. 14, according to government officials.

The savings are minuscule next to the Congressional Budget Office's Jan. 26 projection of a $1.5 trillion budget deficit for fiscal 2011. Still, they would pay for a month's worth of Medicare bills or cover almost all of the Education Dept.'s annual discretionary budget. "That's the largest year-to-year decrease in total war funding" since the Afghan war began in October 2001, Todd Harrison, a defense budget analyst for the nonpartisan Center for Strategic and Budgetary Assessments in Washington, said in an e-mail.

The proposed $117 billion war budget for fiscal year 2012, which begins on Oct. 1, would be the lowest expenditure for the wars since fiscal 2005, when it was $102.6 billion, says Amy Belasco, a war-cost analyst with the nonpartisan Congressional Research Service (CRS).

The war-spending request will be in addition to the $553 billion defense budget for fiscal 2012, the officials say. That compares with the $525 billion Congress allocated for this fiscal year, says Stephen Daggett, an analyst with the CRS.

The drop from the Pentagon's fiscal 2011 war-spending request of $159 billion reflects Obama's plan to reduce troop levels in the war zones and impose stricter rules on what costs can be included in the war budget, say the officials, who decline to be named because the budget has not been formally released. Most U.S. troops are scheduled to leave Iraq by the end of this year, and Obama has said he wants to start drawing down troops in Afghanistan in July.

The Pentagon today has roughly 97,000 troops in Afghanistan and 47,000 in Iraq. The 144,000 total is the lowest since July 2006, when the U.S. had about 148,100 deployed, according to the CRS. Annual Pentagon-only war costs peaked at $179.2 billion in fiscal 2008, with the height of troop deployments to both nations totaling 194,000 in May 2008. From the September 2001 terrorist attacks through last Sept. 30, the end of fiscal 2010, Congress authorized $1.2 trillion to pay for military operations, base security, embassy costs, and homeland defense air patrols, the CRS says. Ⓑ —*Tony Capaccio*

The bottom line *Obama's next war budget will free up money that could go toward the deficit or pay for pressing domestic needs.*

FROM TOP: MARK RICHARDS/COMPUTER HISTORY MUSEUM; DMITRY KOSTYUKOV/AFP/GETTY IMAGES

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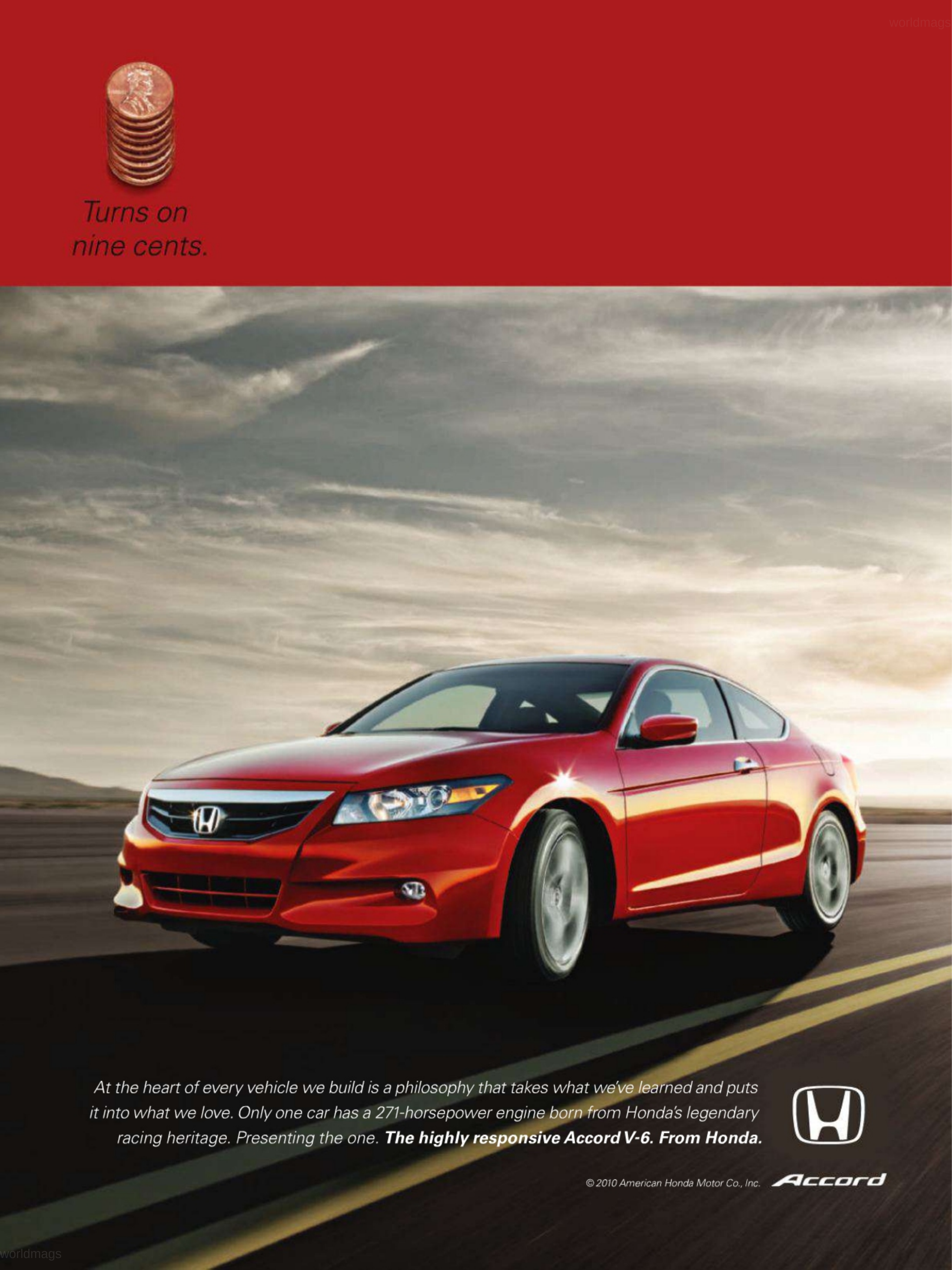
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▶ Silicon Valley's Computer History Museum is rebooted 35 ▶ The government's plan for a single secure password 36 ▶ Riverbed's business and valuation are in the cloud 38 ▶ At MIT, an argument for "sloppy chips" 40
Edited by Barrett Sheridan

Technology

HP Cancels *The Board And the Beautiful*

▶ **With a recent shakeup, Hewlett-Packard's board hopes to leave its soap opera behind**

▶ **The new lineup includes tech veterans, but "where is the hard-charging innovator?"**

When some of **Hewlett-Packard**'s board members became concerned about leaks to the press six years ago, they hired investigators to spy on fellow directors and reporters—creating a high-profile scandal. Then, HP's board tried to distance itself from controversial Chief Executive Officer Carly S. Fiorina by replacing her with Mark V. Hurd, a relatively unknown numbers guy from the Midwestern cash machine maker **NCR**. That back-to-business move worked—until a sexual harassment allegation from a B-movie actress-turned-marketing consultant triggered Hurd's abrupt resignation and a soap-opera-level feud between him and the HP board.

Under the new management of Chairman Raymond J. Lane and CEO Léo Apotheker, who both arrived in November shortly after Hurd's departure, HP's board is trying to put the drama behind it once and for all. On Jan. 20, HP announced the resignation of four directors who, according to several people familiar with the matter, had expressed firm feelings—both for and against—the company's handling of the Hurd situation. They're being replaced by five fresh faces.

The extensive overhaul put HP back in the spotlight and caught the attention of corporate governance experts. "That is quite a major change, to say the least," says William W. George, a professor of management practices at Harvard Business School. The departure of so many independent directors at once "is very rare unless there is something that comes to the level of a bankruptcy."

If the latest moves help the HP board finally shake its drama queen image, much of the credit will go to Lane, the former president of **Oracle** and a managing director at venture capital firm Kleiner Perkins Caufield & Byers.

Lane spearheaded the board makeover and chose to forgo hiring a search firm, relying instead on his own Rolodex and powers of persuasion. "Ray did a lot of work to reach out to the people being considered," says Bill Wohl, an HP spokesman. "Every one of them said, 'Sign me up.'" His actions typified the decisiveness that earned Lane, 64, accolades during his running of day-to-day operations at Oracle. "The headline here is that Ray, as the chairman of the board, is taking control and putting his own stamp on it," George says. "He is not some passive lawyer just overseeing things."

The board shakeup is also an effort to bolster HP's main business selling computing equipment to large companies. Several of the departing directors have little experience in that area. Former director Joel Z. Hyatt, for instance, is a lawyer, entrepreneur, and vice-chairman at **Current Media**, a television broadcaster specializing in programming submitted by viewers. Lucille S. Salhany, another departing director, is a former Hollywood



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Wells Fargo is ready to roll page 43 ▶



HP could have done more to reassure shareholders by naming a gadget whiz or cloud guru to the board

executive and CEO of consulting company **JHMedia**.

Who's replacing them? Heavy hitters in the technology industry such as Meg C. Whitman, the former CEO of **eBay**; Patricia F. Russo, former CEO of **Alcatel-Lucent**; and Gary M. Reiner, the former chief information officer at **General Electric**. Their expertise in large-scale e-commerce, networking equipment, and business computing may help HP extend its lead as the world's largest supplier of technology infrastructure equipment.

George and other observers say Lane's board shakeup is a sign the chairman is preparing HP for confrontation as its business lines collide with those of powerful rivals. In the 1990s, enterprise computing companies including HP, Oracle, **EMC**, and **Cisco Systems** were content to make billions in their distinct niches. Those lines are now blurring. HP is stepping on Cisco's networking turf through its acquisition of **3Com**. Oracle's purchase of **Sun Microsystems** threatens HP's line of servers and storage systems. Cisco has started selling servers that compete with gear made by HP and Oracle.

These companies sense the approach of an inflection point as business customers make the transition from older technologies to the new era of cloud computing, where software applications run in data centers and connect to PCs over the Internet. To take advantage of the cloud, businesses must upgrade to newer, faster equipment and applications. HP and its competitors are vying to be full-service suppliers that can fulfill all of a customer's cloud computing needs.

Tensions between HP and Oracle have run particularly high. Within a month of Hurd's ouster from HP he became a co-president at Oracle, prompting HP to file a lawsuit against its former CEO. (The suit was quickly settled.) Lane left Oracle on acrimonious terms with its outspoken CEO, Larry Ellison, and Apotheker used to run Oracle's archrival, business software maker **SAP**. "I think there is a huge emerging story, and that is the HP-Oracle war," says Harvard's George. "I think Ray Lane is gearing up for that and needs a board that understands that."

The board changes may do a lot for HP strategically, but the company still faces many of the same product challenges that have dogged it for years. "The disturbing thing is that I don't see people [on the board] who have built anything in terms of manufacturing," says Michael S. Malone, who wrote *Bill & Dave*, a book about the company's co-founders, William Hewlett and David Packard. "And where is the hard-charging innovator that is out there ahead of everyone else?"

In fast-growing areas such as mobile computing and cloud-based business software, HP has fallen behind. The company was once a powerhouse in the market for personal digital assistants, but the smartphone revolution has passed it by. That's a major issue, since HP is the world's largest PC maker; smartphone sales have already passed laptop sales and are expected to outpace total PC sales in 2012. Similarly, HP missed the early rush into tablet computing. Analysts estimate that roughly 100 iPad competitors were introduced at the Consumer Electronics Show in early January, but HP has yet to issue a serious response. The company's sluggishness in these areas is particularly worrisome given that consumers increasingly are shaping technology trends, even at the office.

In the area of cloud technology, HP didn't formally unveil a product lineup to customers until Jan. 25. Rivals such as **Amazon.com**, **Microsoft**, and **Google** have spent years wooing customers to use their wares, such as business software accessed through the Internet. "That's one area where HP's story is least understood" by customers, says Abhey Lamba, an analyst at ISI Group in New York. "They have more work to do."

HP could have done more to reassure shareholders by giving a board position to a gadget whiz or a cloud computing guru such as **Salesforce.com** CEO Marc Benioff, says one longtime HP investor, who requested anonymity so as not to upset his relationship with the company. That would have addressed concerns about its ability to forecast technology trends and outflank competitors technologically, rather than rely on size and efficiency for success. "They are full of slow-moving dinosaurs," Malone says. "It's about time that [management] steps up and trusts people enough to take some risks."

The first glimpse of HP's risk tolerance under Apotheker and Lane could arrive in February. HP has scheduled an event to show off the initial fruits of its acquisition of **Palm**, the smartphone maker it bought last July. Photos and specification sheets for an upcoming Palm tablet have already leaked to the Internet and suggest that the company plans to unveil an iPad competitor. (HP won't comment on the authenticity of the leaked documents.) Apotheker is set to reveal HP's new strategy in mid-March; in the past, he's talked about providing more funding for research and development, which suffered under Hurd.

As for controlling the drama, Lane has vowed that the board he chairs will keep a lower profile. "The board needs to operate in privacy," he says.
—*Ashlee Vance with Aaron Ricadela*

What the new board brings to HP

❶ Shumeet Banerji

The CEO of consultancy Booz & Co., Banerji spent many years working in Europe, giving HP a better understanding of overseas markets

❷ Gary Reiner

HP specializes in selling technology equipment to large corporations. Reiner, former chief information officer for GE, understands how customers think

❸ Patricia Russo

Russo knows networking equipment—she was the CEO of Alcatel-Lucent—and will help HP compete in the high-profit market for routers and switches

❹ Dominique Senequier

As the CEO of AXA Private Equity, Senequier is one of the most powerful female executives in Europe. Lane praises her "strong financial acumen"

❺ Meg Whitman

The former head of eBay, Whitman can help HP understand what kind of equipment and services big Internet companies need

The bottom line *HP says a recent boardroom shakeup gives it greater tech expertise and a break with the board's operatic past.*

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Tech History

Silicon Valley Gets A Memory Upgrade

▶ The Computer History Museum reopens after a $19 million redo

▶ Before, "there were just hulking machines sitting in a corner"

In Silicon Valley, nostalgia is an unwelcome diversion. This is a region ruled by Moore's Law, an observation about improvements in transistor size that turned into a commandment that technology get faster, better, and cheaper all the time. People here trample the old in pursuit of the new—and have little time to recollect.

All of which would seem like bad news for the Computer History Museum. Since its opening here in 2002, the Mountain View (Calif.) institution has mostly been a modest gallery, basically a warehouse full of old mainframes, supercomputers, and PCs with placards tacked on them. Only a few hundred people visited each week. "Nothing had any explanation," says Leslie Berlin, the project historian for Stanford University's Silicon Valley Archives. "There were just hulking machines sitting in a corner."

On Jan. 13 the Computer History Museum got a reboot—although in a sense it's a whole new product. Thanks to a $19 million renovation (financed in large part by a $15 million gift from the Bill & Melinda Gates Foundation), the building has been transformed from an under-trafficked storage facility into a proper museum that documents the rise not only of computers but also of technology over thousands of years. Silicon Valley, ever focused on the future, now has a temple honoring the past.

The museum sits just off Highway 101, next door to **Microsoft**'s Silicon Valley campus and about a mile from the Googleplex. The building itself is a relic, the former home of hardware giant **Silicon Graphics**, which boomed, busted, and relocated to a humbler site in the early 2000s.

The old version of the museum was an exercise in minimalism. An exhibit on the history of chess-playing machines and computers was the only one recognizable as well-designed museum fare. Version 2.0, by contrast, carries a dramatic flourish. The designers borrowed the aesthetic of an **Apple** store to give their 25,000 square feet of exhibition space a crisp, modern feel. The main entrance evokes computing's early days with punch-card patterns on the floor. Visitors are greeted by the sound of modems gurgling as they connect to the Web.

In the first five days after reopening, nearly 1,700 visitors trekked through the museum's 19 interlinked galleries, which provide a journey through the history of technology, from the abacus to the iPod. The exhibits are complemented by multimedia displays, including old Apple commercials and an exploration of how companies such as **Intel** manufacture chips. The galleries play off "hero objects" such as the original trash-can-size disk drive; the first personal digital assistant, the Palm Pilot; and the Xerox Alto, an early version of the PC.

Stanford's Berlin says the oral history displays, in which engineers and company founders reflect on their work, are some of the museum's nicer touches. "People here are so focused on trying to figure out what the next decade will bring that they think of themselves as not giving much attention to the past," she says. Yet every technology company has what Berlin calls a "storytelling tradition," often including tales of audacious decisions that gave a company its character.

The collection has 100,000 artifacts, although most are stored in a nearby facility available to researchers. The items on display include **IBM** songbooks (*Hail to the IBM*, anyone?), a $10,000 kitchen computer from 1969 designed to help housewives with recipes, early virtual reality devices, enormous supercomputers built by hand with 100 miles of wiring, vacuum tubes galore, and the first

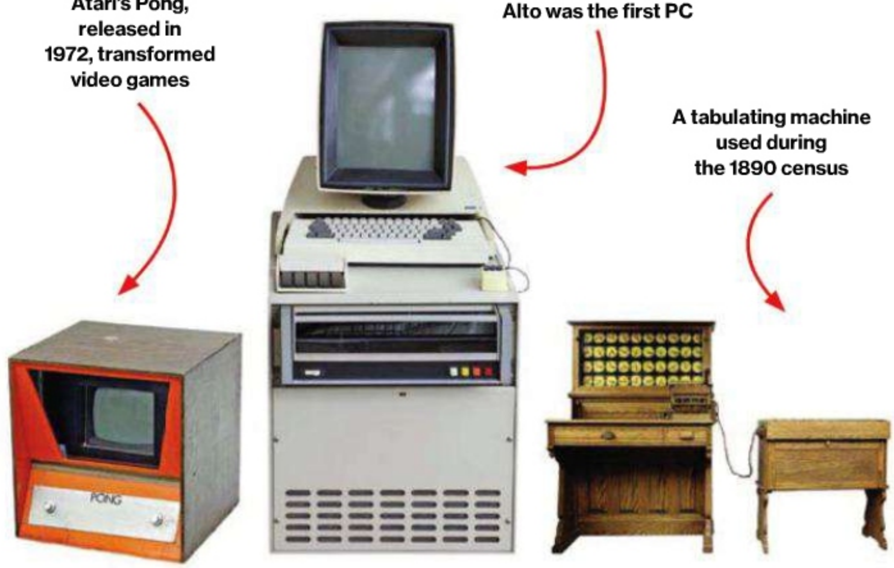
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MILLION

The number of discounted $20 Amazon gift cards sold on Jan. 19 by group-buying site LivingSocial, which says it was the largest online coupon deal ever.

DATA: LIVINGSOCIAL



Atari's Pong, released in 1972, transformed video games

Combining a mouse and a visual interface, the Xerox Alto was the first PC

A tabulating machine used during the 1890 census

FROM TOP: MANSELL/TIME LIFE PICTURES/GETTY IMAGES; MARK RICHARDS/COMPUTER HISTORY MUSEUM (3)

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Google servers. There is also a hunk of the bar from the Wagon Wheel, a local watering hole where venture capitalists, CIA agents, and KGB spies used to hang out to imbibe and gauge the state of the industry. "There's just way too much to see in the time I thought I had," says Bruce Molyneux of Bristol, England, who visited the museum during a recent business trip.

The juxtaposition of new(ish) and old resonated with many of the visitors who checked out the upgraded museum on its opening weekend. "It really puts things in perspective," says Benny Hsieh, a local technology administrator. "You really get a feel for how all this started."

Tourists and locals have long mourned the dearth of historic sites in the Valley. The headquarters of the first semiconductor businesses have given way to fruit stands and retail storefronts. The famed garages where Hewlett and Packard, Jobs and Wozniak, and Brin and Page developed their innovations remain private property, generally off-limits to the public. The upgraded Computer History Museum is a place for the technologically curious to learn where modernity came from–or maybe just to play Pong on an oversize screen. —*Ashlee Vance*

The bottom line *After an impressive renovation, the Computer History Museum is a monument to the past in a region that forgets it has one.*

Cybersecurity

Say Goodbye to All Those Passwords

▶ The government is backing a system to verify identities online

▶ A fix for "one of the fundamental challenges of the Internet today"

The Problem with Passwords

They're annoying to remember, insecure, and costly for companies.

Most-Used Passwords

1. 123456
2. password
3. 12345678
4. qwerty
5. abc123

30% Proportion of help desk calls that are password-related

$10 Average amount it costs a business to field a phone call requesting a password reset

50% Users who choose a common word or simple key combination for a password

Time It Takes a Hacker's Computer to Randomly Guess Your Password

Length	Lowercase	+ Uppercase	+ Nos. & Symbols
6 characters	10 minutes	10 hours	18 days
7 characters	4 hours	23 days	4 years
8 characters	4 days	3 years	463 years
9 characters	4 months	178 years	44,530 years

DATA: GARTNER, FORRESTER, DUO SECURITY, IMPERVA, LASTBIT SOFTWARE

The convenience promised by the Internet often seems to evaporate when you log in every morning. First comes the user name and password needed to boot up your smartphone or computer. Next, a different password to access your e-mail. Want a book at **Amazon.com**? Another password (what was your first pet's name again?) and often your credit-card information and address. Buying boots at **Zappos.com**, reserving a plane ticket, or checking your bank balance after all that spending? Get ready with password after password.

The U.S. Commerce Dept. is spearheading a new online security system that experts say will eliminate the password maze and perhaps boost e-commerce. The plan calls for a single sign-in each time a computer or phone is turned on, using a device such as a digital token, a smartcard, or a fingerprint reader. Once logged in, users would have access to any website that has signed up for the program. "You are your password in this system," says John Clippinger, co-director of the Law Lab at Harvard's Berkman Center for Internet & Society and an advocate of the plan. "It will be far more efficient and you'll control it much more." Activities now done offline because of security or privacy concerns–evaluating medical records or refinancing a mortgage–might migrate to the Web following adoption of the new rules, called the National Strategy for Trusted Identities in Cyberspace, or NSTIC.

Passwords don't provide good security because most people choose character combinations that are easily hacked. A universal standard that requires some kind of device or a chip with encrypted data would keep consumer information safer while assuring companies they aren't being scammed, says Don Thibeau, chairman of the Open Identity Exchange, an industry group representing large tech companies such as **Verizon**, **AT&T**, **Google**, **PayPal**, and **Symantec**. "NSTIC could go a long way toward advancing one of the fundamental challenges of the Internet today, which is, 'Who do you trust?'" Thibeau says. "This gives us the rules, the policies that we need to really move forward."

A security standard could also cut the size of Internet company help desks, says Bruce McConnell, a counselor for national protection at the Homeland Security Dept. "The highest cost element of help desks is dealing with lost passwords," he says. Another plus: A trusted online ID may encourage doctors to prescribe more drugs electronically, helping to save 3 million sheets of paper a year, McConnell says.

The federal government is developing the standards for the security and verification plan, but it will be voluntary, and companies that use the system will manage it. There will be no central database of user information, Commerce Dept. officials say, removing concerns over privacy. Instead, each company will maintain its own database of

➜

Tweeted

"Its official. I just became the Director of Creative Innovation for intel. every beat I make is made with intel. And now were partners."

—Black Eyed Peas frontman will.i.am, announcing his new partnership with Intel on Jan. 25



DANNY MARTINDALE/FILMMAGIC/GETTY IMAGES

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customers, and anyone logged in by one company would be considered safe by others using the system.

While companies have not yet said they will join the program, if the system allows them to adapt it easily for their purposes, usage could soar, says Brian Kissel, chairman of Janrain, a social networking consulting firm. "The pull will come from user demand," Kissel says. The government has promised to jump-start the plan by encouraging agencies to use it for everything from taxes and veterans benefits to reserving campsites at national parks. "Innovation is one of the key aspects here," says Ari Schwartz, an Internet policy adviser at Commerce. "There's so much that could be done if we could trust transactions more." —*James Sterngold*

The bottom line *The government is backing a new online security system that could boost e-commerce by requiring a single sign-on for multiple websites.*

Enterprise

The Muhammad Ali Of Cloud Computing



MARK LENNIHAN/AP PHOTO

▶ **Riverbed's Kennelly racks up results and makes bold predictions**

▶ **"Jerry's a bit of a loose cannon," says an analyst fan**

Jerry Kennelly talks like a man who slept through the B-school class on managing investor expectations. Although shares of **Riverbed Technology** have risen 520 percent in the past two years and doubled since July, he scoffs at the idea that his company, with $5 billion in market capitalization, is in a bubble. "We're just reaching a reasonable valuation," says Riverbed's co-founder and chief executive officer. "We're just reaching the floor of what we can be."

That may sound imprudent, but

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Kennelly—a CPA by training and former finance executive at tech highfliers **Oracle** and **Inktomi**—has reasons for optimism. Riverbed, along with others such as **F5 Networks** and **Blue Coat Systems**, sells networking technologies that let companies run software housed in far-off data centers more efficiently. While there's no catch-all name for the market—"application acceleration" is about the best of them—these products are emerging as one of the fastest-growing new tech sectors to come along in years. "These companies have not seen their best days," says Gleacher analyst Brian Marshall.

That's despite a sell-off that followed F5's Jan. 19 earnings call, when the company predicted it would miss Wall Street's consensus sales forecast this quarter by 2 percent or less. By Jan. 24, shares had fallen 24 percent. Riverbed and Blue Coat also traded down. Yet analysts such as Marshall expect the application-acceleration market to grow more than 20 percent per year. He says the lower stock prices might make the companies attractive to the likes of **Hewlett-Packard**, Oracle, or **IBM**. F5's market cap now stands at $8.8 billion. "Nobody could afford F5 at $150 a share, but it might make sense at $100," says Marshall.

The main reason for the bullishness is cloud computing. Corporations can theoretically save big money by moving e-mail, accounting, and other applications off individual PCs and into data centers—that is, the cloud. Rather than requiring techies to swarm offices for the constant updating of applications such as Microsoft Office, updates can happen once at the data center. That only makes sense if the software in question works as fast in the cloud as it would on a PC. The expensive way to acquire that speed is by purchasing lots of bandwidth. Riverbed's software circumvents the problem by minimizing the information that needs to be transferred between a data center and a company's headquarters, branch offices, and other facilities.

The company makes devices costing up to $250,000 that businesses install in their data centers, and complementary ones costing as little as $5,000, which sit in the various offices that connect to the data center. Commonly used files—say, PowerPoint sales presentations—are sent only once and stored on the

Microsoft

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Innovator

Joseph Bates



Processors are very accurate. An MIT computer scientist says making them more error-prone could mean faster, more powerful computers

What's the square root of 10? If you had to do it in your head, you might say "a little more than three." Computers, unlike humans, don't do back-of-the-envelope calculations. They just crunch the numbers to the last requested decimal place.

Joseph Bates, however, thinks we'd be better off if we were to let computers make some mistakes. Bates, 55, a computer scientist at Carnegie Mellon and the MIT Media Lab, has designed a chip that does what computer engineers call "sloppy arithmetic," or guesstimating. Slightly inaccurate chips would be "much, much littler and much, much more efficient" than current chips, he says. Accurate calculation is a series of discrete tasks, such as carrying numbers when summing figures, that take up valuable processing power. By ignoring some of those tasks, Bates's chip, he predicts, would have something like 100,000 times the computing power of a traditional processor.

With an error range around 1 percent, Bates's chip wouldn't be wildly inaccurate: One plus one might equal 2.02. In many applications, the resulting errors would either be imperceptible or automatically corrected. In digital photography and medical imaging, for instance, errors in the range of 1 percent would be invisible to the human eye. With other tasks, such as needle-in-a-haystack searches for particular images or sound files, Bates's chip could rifle through enormous databases, winnowing the list down to a few candidates for a more deliberate processor—or human being—to pick from. Bates foresees his chips being paired with traditional Intel-style chips for this purpose. The result: smartphones with the computing power of desktops, and desktops with the power of supercomputers.

While he hasn't fabricated a sloppy chip yet, Bates sees the engineering as fairly basic. There's a consensus among chip engineers that, as Bob Colwell, formerly the chief designer of Intel's Pentium chips, puts it, "whatever challenges are down the hardware path are probably overcome-able." Bates says several companies are looking at the technology, though nondisclosure agreements prevent him from naming them.

Bates's central research interest has always been artificial intelligence—like many researchers, he came to the topic by reading Isaac Asimov as a boy. Growing up in Baltimore, he skipped high school and went to Johns Hopkins University at 13. In some of his earliest research, he tried to get computers to think like creative human mathematicians, to do the equivalent of word problems rather than the abstract language of sets and equations. His turn to sloppy arithmetic follows in this vein: Part of its promise is that it could help computers act more like the human brain, which takes all sorts of shortcuts to answer problems. "By allowing things to be approximate, you're a lot closer" to achieving true artificial intelligence, says Bates. —*Drake Bennett*

Boy Genius ▶ **Skipped high school and entered Johns Hopkins at age 13**

Inspiration ▶ **The fiction of Isaac Asimov led him to be an A.I. researcher**

Potential ▶ **"Sloppy" chips could make computers 100,000 times faster**

Technology

cheaper machines, so they're instantly accessible to employees. Riverbed's gear quickly compresses the rest of the traffic, stripping out unseen bits such as e-mail headers. If someone in headquarters updates that sales presentation, only the new numbers are sent to the other offices—not the entire document.

Joseph Fusco, head of application development at **British Telecommunications**' U.S. services arm, says Riverbed's gear typically reduces the bandwidth necessary to run Office or Lotus Notes by more than 40 percent. "When people notice they can download a file in 20 seconds rather than 20 minutes, their eyes light up," says Fusco. The industry term for Riverbed's technology is WAN (for wide-area network) optimization. F5, for its part, makes more expensive machines that route traffic within the data centers, assigning computing tasks to those servers best prepared to handle them. F5 says its customers can get by with fewer servers, since the system makes sure each one is more fully utilized.

Fewer than one-fifth of companies have deployed application-acceleration technology, says Kennelly, so there's plenty of room for growth. "Every global company in the world will need this technology," he says. Riverbed had sales of $499 million in the 12 months ended last September. That gives it a 40 percent share of the WAN optimization market, up from 28 percent in 2009.

What about **Cisco Systems**, the $40 billion-a-year king of the networking-gear business? Although Cisco recently started loading its own application-acceleration technology for free on some of its routers, analysts such as Erik Suppiger of investment bank Signal Hill say Riverbed's tech edge will keep it in front. Kennelly professes no fear of Cisco. "Routers are a Rust Belt industry. They're still necessary, but it's not where the excitement is," says Kennelly. "We'll be one of the great tech companies for the next 100 years."

Networking analysts have grown used to such Muhammad Ali-like pronouncements. "Jerry's a bit of a loose cannon," says Suppiger. Kennelly retorts: "I'm not a loose cannon. I'm ebullient about our business. And I've been right all along." —*Peter Burrows*

The bottom line *Riverbed CEO Kennelly's soaring optimism has been backed up by the company's impressive performance.*

PHOTOGRAPH BY MICHAEL WARREN FOR BLOOMBERG BUSINESSWEEK

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WHEN WE FRANCHISED WE HAD TWO QUESTIONS:

WHO'S RUNNING IT? AND WHEN CAN WE MEET THEM?

-Alasdair Clements and Nathan Withrington, GoCar founders

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Wells Fargo Is Ready to Roll

▶ Careful lending practices helped it dodge many of the mortgage woes plaguing its rivals

▶ "They have weathered the storm far better than most"

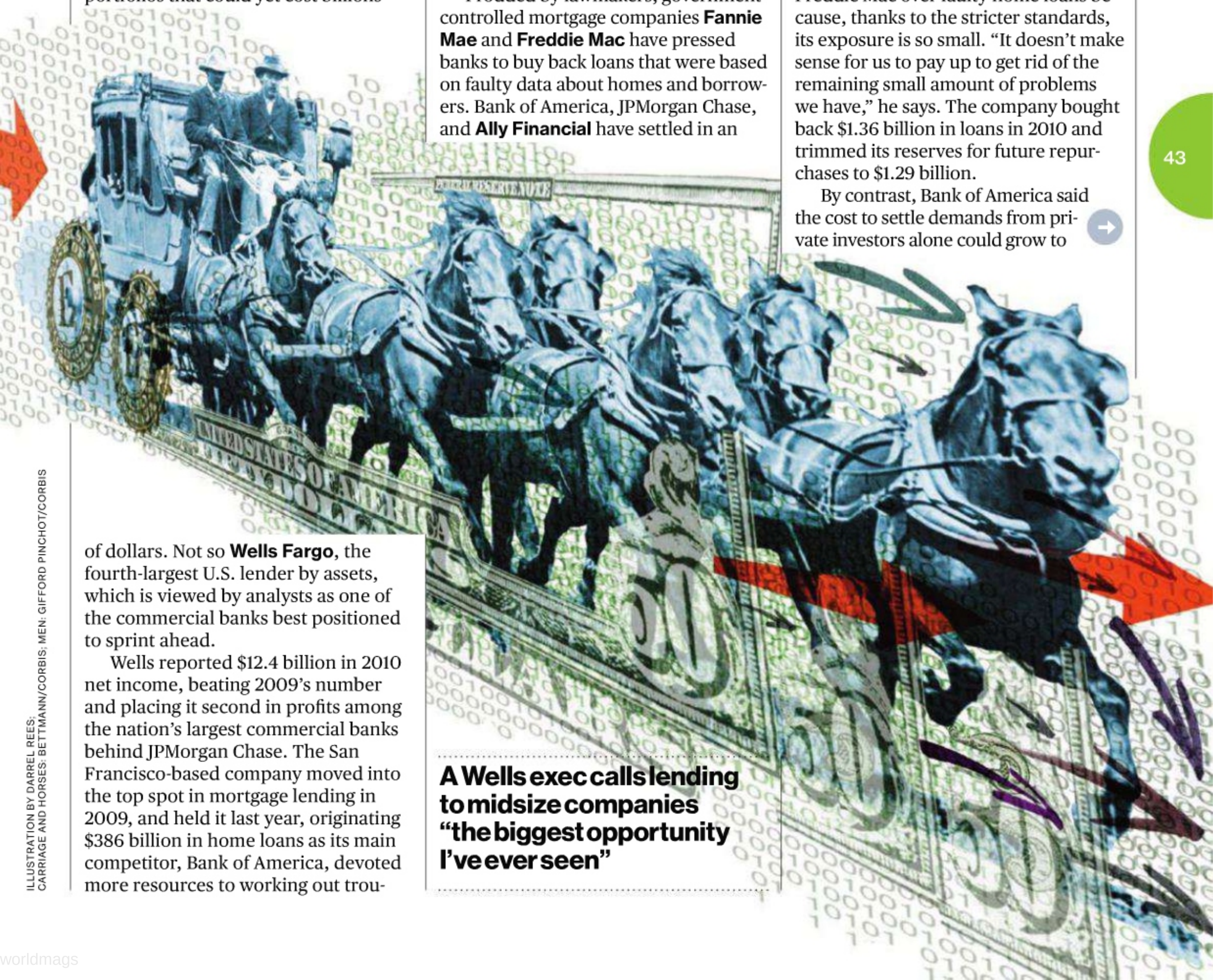
Some of America's premier commercial banks, from **Bank of America** to **JPMorgan Chase**, are still digging out from the 2007-2009 financial crisis, facing fat settlements and legal fees to resolve claims related to their mortgage portfolios that could yet cost billions of dollars. Not so **Wells Fargo**, the fourth-largest U.S. lender by assets, which is viewed by analysts as one of the commercial banks best positioned to sprint ahead.

Wells reported $12.4 billion in 2010 net income, beating 2009's number and placing it second in profits among the nation's largest commercial banks behind JPMorgan Chase. The San Francisco-based company moved into the top spot in mortgage lending in 2009, and held it last year, originating $386 billion in home loans as its main competitor, Bank of America, devoted more resources to working out troubled mortgages. "Wells is in a uniquely strong position to continue to outperform its peers," says Andrew Marquardt, an analyst at Evercore Partners in New York. "They have weathered the storm far better than most."

Prodded by lawmakers, government-controlled mortgage companies **Fannie Mae** and **Freddie Mac** have pressed banks to buy back loans that were based on faulty data about homes and borrowers. Bank of America, JPMorgan Chase, and **Ally Financial** have settled in an effort to limit their liability. Bank of America paid $2.8 billion in December to end some repurchase demands.

At Wells, Chief Financial Officer Howard I. Atkins says the bank won't seek settlements with Fannie Mae or Freddie Mac over faulty home loans because, thanks to the stricter standards, its exposure is so small. "It doesn't make sense for us to pay up to get rid of the remaining small amount of problems we have," he says. The company bought back $1.36 billion in loans in 2010 and trimmed its reserves for future repurchases to $1.29 billion.

By contrast, Bank of America said the cost to settle demands from private investors alone could grow to



A Wells exec calls lending to midsize companies "the biggest opportunity I've ever seen"

ILLUSTRATION BY DARREL REES; CARRIAGE AND HORSES: BETTMANN/CORBIS; MEN: GIFFORD PINCHOT/CORBIS

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as much as $7 billion to $10 billion. The Charlotte (N.C.)-based lender reported a $1.24 billion loss for the fourth quarter on costs to end mortgage disputes, while JPMorgan put aside $1.5 billion in litigation reserves to cover similar expenses.

Consider this odd tribute to the relative quality of Wells Fargo's underwriting: According to the Securities and Exchange Commission, **Paulson & Co.**, the New York hedge fund, helped **Goldman Sachs** choose bonds tied to shaky mortgages to bundle into a security that later led Goldman to a $550 million settlement with the SEC. In its lawsuit against Goldman Sachs, the SEC cited e-mails saying Paulson rejected Wells Fargo's subprime mortgage bonds. Why? Because the bank "was generally perceived as one of the higher-quality subprime loan originators."

Still, Wells Fargo and its chief executive, John Stumpf, haven't avoided all issues tied to soured mortgages. When it bought Wachovia in 2008, Wells Fargo inherited a portfolio of option-ARMs (mortgages that let borrowers defer some payments), which have some of the industry's highest default rates. Wells Fargo still has about $90 billion in unpaid principal on that portfolio. The lender set aside more than $26 billion at the time to soak up losses on those loans and hasn't yet exhausted the cushion. And the bank said in October that, much like rivals, it would submit supplemental affidavits to courts in about 55,000 foreclosure cases after finding some didn't adhere to requirements.

The strength of its mortgage operations means Wells can exploit new opportunities in areas such as lending to midsize businesses, Marquardt says. Wells Fargo has 2,400 employees who focus on businesses that have $10 million to $500 million in revenue. It plans to increase that workforce by more than 10 percent this year, according to Perry Pelos, the executive in charge of the unit.

Pelos says that Wells Fargo's 187 commercial banking branches across the U.S. will distinguish it from larger rivals with fewer offices. Wells Fargo will also get a leg up by allowing local salespeople to make credit decisions and by offering a wider variety of loan products than smaller rivals, he says. "I've been in the commercial banking business for 25 years, and this is the biggest opportunity I've ever seen," Pelos says. "Shame on us if we don't take advantage of it."

The expansion sets up a clash with rivals that have also targeted commercial lending as an area for growth. **U.S. Bancorp** and **PNC Financial Services Group** are among many that have said recently they're putting more resources into commercial lending.

And lending is likely to remain sluggish as companies with near-record amounts of cash hold off borrowing, according to Paul J. Miller Jr., a former examiner for the Philadelphia Federal Reserve Bank and analyst at FBR Capital Markets. Until companies draw down their cash, he says, they won't need bank loans.

Even in such an environment, Wells Fargo's ability to avoid some of the major mortgage troubles slowing rivals gives it an edge, says D. Anthony Plath, a finance professor at the University of North Carolina at Charlotte's Belk College of Business: "That's why Wells can pursue strategic initiatives whereas Bank of America is essentially fighting fires." —*Dakin Campbell*

The bottom line *Wells Fargo avoided many of the mortgage problems plaguing its rivals, leaving it in a strong position to expand its commercial lending.*

6.85

BILLION DOLLARS

The value of the European Financial Stability Facility's inaugural bond sale, intended to help fund Ireland's bailout. The Japanese government bought more than 20 percent of the bonds.

DATA: EFSF

Housing

Fannie and Freddie's Big Foreclosure Backlog

▶ **While they want to avoid a fire sale, they may be forced to cut prices**

▶ **"The focus has always been on supporting neighborhood values"**

Fannie Mae and **Freddie Mac** are trying to sell their huge backlog of foreclosed homes in an orderly way to avoid flooding the market and depressing prices. As foreclosures mount, though, analysts say the companies may be forced to reconsider that approach.

The government-controlled mortgage companies' inventory of foreclosed residential property has quadrupled in three years and now stands at a record $24 billion. The number of properties they own has increased fivefold to nearly 242,000, representing roughly a third of all repossessed homes in the U.S. And the total keeps growing as they take possession of homes faster than they can sell them. In the first nine months of 2010 Fannie and Freddie took in 319,243 foreclosed properties and disposed of 210,105. At the same

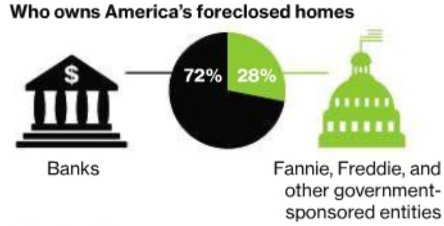
Housing Glut

Fannie Mae and Freddie Mac are taking possession of homes faster than they're selling them

Properties subject to a foreclosure filing

2010	2011 (forecast)
2,870,000	3,444,000

Who owns America's foreclosed homes



Sales backlog

Banks	Fannie/Freddie
51% of inventory is on the market	61% of inventory is on the market

Fannie and Freddie's inflow/outflow

Sold 210,105 properties in 2010*...

...acquired 319,243

*THROUGH SEPT. 30
DATA: BLOOMBERG, REALTYSTORE, REALTYTRAC

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time, U.S. housing prices have been falling. In the most recent reading, the S&P/Case-Shiller index of home values in 20 cities fell 1.6 percent in November from the previous year, the biggest 12-month decrease since December 2009.

Officials at Fannie and Freddie say they are committed to an approach consistent with their mission as backstops for the housing market. They have been trying to stabilize neighborhoods by selling homes at prices close to market levels and giving preference to buyers who plan to live in the homes rather than investors who might rent them out or try immediately to resell them. Fannie and Freddie are also investing in some properties, spending millions on maintenance to make them competitive with other homes on the market in their neighborhoods. "We don't want a reduced value to initiate a quick sale," says David Wendling, senior director of REO (real estate owned) sales at Freddie Mac. "The focus has always been on supporting neighborhood values."

Of the 74,621 properties Freddie Mac sold in the first nine months of 2010, 67 percent went to buyers who intended to occupy them, according to company data. At Fannie Mae, about 80 percent of sales are to owner-occupants, says company spokeswoman Amy Bonitatibus. "We don't hold anything back that is available to be sold," says Jane Severn, director of REO disposition at Fannie Mae. "We're doing the opposite, pushing our homes out to the market as soon as we can."

Some real estate analysts say the companies will have to find a way to dispose of properties more quickly. The number of homes subject to a foreclosure filing may rise by 20 percent this year, up from a record 2.87 million properties in 2010, RealtyTrac, an Irvine (Calif.) data company, predicts. The market currently can absorb about a million foreclosures a year, the Mortgage Bankers Assn. estimates. Fannie and Freddie themselves estimate in regulatory filings that it will take "a number of years" to bring their foreclosure inventory down to pre-2008 levels.

As their holdings of unsold homes increase, Fannie and Freddie eventually will need to drop prices and turn to investors, analysts predict. "I think they're just [postponing] the inevitable," says Michael Slaughter, a partner at New Providence Capital, a Dallas-based private lender. "If they don't start with a systematic distribution of these properties to investors who have cash today and will buy them at the right price, they're going to end up selling the entire portfolio to **Goldman Sachs** or **BlackRock** at a tenth of what they can get for them today." —*Clea Benson*

The bottom line *Fannie's and Freddie's strategy of not flooding the market with foreclosed homes may come under pressure as their inventory builds.*

Hedge Funds

Japan: Land of the 210 Percent Return?

▶ Curtis Freeze's Consensus fund ranked No. 2 in the world last year

▶ "Having rebuilt our track record, now we're ready to start marketing"

Japan often gets overshadowed by economic powerhouse China, but consider this: Curtis Freeze posted a 210 percent return last year at his Shareholders' Consensus hedge fund, which invests in Japanese stocks and bonds. That's a remarkable comeback for the fund, which fell 82 percent in 2009, and for Freeze's Honolulu-based firm **Prospect Asset Management**, which has seen its assets under management plummet from more than $2 billion, including real estate holdings, to $280 million in just four years.

The Shareholders' Consensus Fund, with assets of $15 million, trounced the average Japan hedge fund's 8.3 percent return and notched the second-best return of all hedge funds worldwide last year, according to Eurekahedge, a Singapore-based researcher that tracks 6,734 funds. The top performer was Precision FX, a currency fund that returned 221 percent. Freeze hopes his success in 2010 helps him attract $85 million in additional investments over the next 18 months. "A near-death experience" is how he describes his losses. "Having rebuilt our track record," he says, "now we're ready to start marketing again."

A native New Yorker, Freeze, 48, arrived in Japan 30 years ago as a Mormon missionary. He began his investment career at Nikko Securities (now Nikko Cordial Securities) in 1988, just before Japan's bubble economy burst, and worked at two other financial firms before setting up Prospect Asset Management in 1994. Along with the Consensus fund, launched in 2005, Freeze manages the Prospect Japan Fund and individual accounts. He loaded up on Tokyo land and residential buildings starting in 2002, when Japan was emerging from its third recession in a decade. The collapse of Lehman Brothers and the onset of the global credit crisis in 2008 ➜



Freeze took a big hit when the Tokyo property market collapsed

FROM TOP: CARLOS ALVAREZ/GETTY IMAGES; TOM BONAVENTURE/GETTY IMAGES

210%

Freeze's Shareholder Consensus Fund return in 2010

sent Tokyo property prices plummeting, and the Consensus fund took a severe hit. In response, Freeze diversified. The fund now has about a third of its assets in property-related investments, he says, down from 90 percent in 2007. "One thing we learned was to not fall in love with property," says Freeze. "We're now more opportunistic."

The Consensus fund focuses on companies with a market value of $100 million to $1 billion that don't have a lot of analyst coverage. It profited last year from stakes in niche companies such as **Zuiko**, an Osaka-based manufacturer of diaper-making machinery that is benefiting from rising demand for disposable diapers in Asia. Investments in distressed debt, such as that of consumer finance companies **Takefuji** and **Orix**, helped the fund's performance as well.

With a few investments, Freeze has pursued an activist strategy. Last year the fund invested in **Gro-bels**, a Tokyo-based property developer. He used his stake to vote himself in as president of the company in June. Freeze says he has been able to use his connections in the financial industry to develop new sources of funding for the company. The stock has doubled since he bought it. Freeze recognizes that his skills as a stockpicker aren't enough to attract investors. "My strength is I've always focused on Japan and, of course, that's my weakness, too," he says. "When Japan goes out of favor like it did for a while, there is no interest in what I'm doing, but now people are coming back to Japan. ... I'm not embarrassed to say I'm a Japan specialist."

—*Tomoko Yamazaki and Komaki Ito*

The bottom line *Having broadened his focus beyond property investments that suffered in the financial crisis, Freeze is enjoying a remarkable comeback.*

Government Bonds

The Two-Year Rally in TIPS May Be Over

▶ With inflation tame, demand for the securities is waning

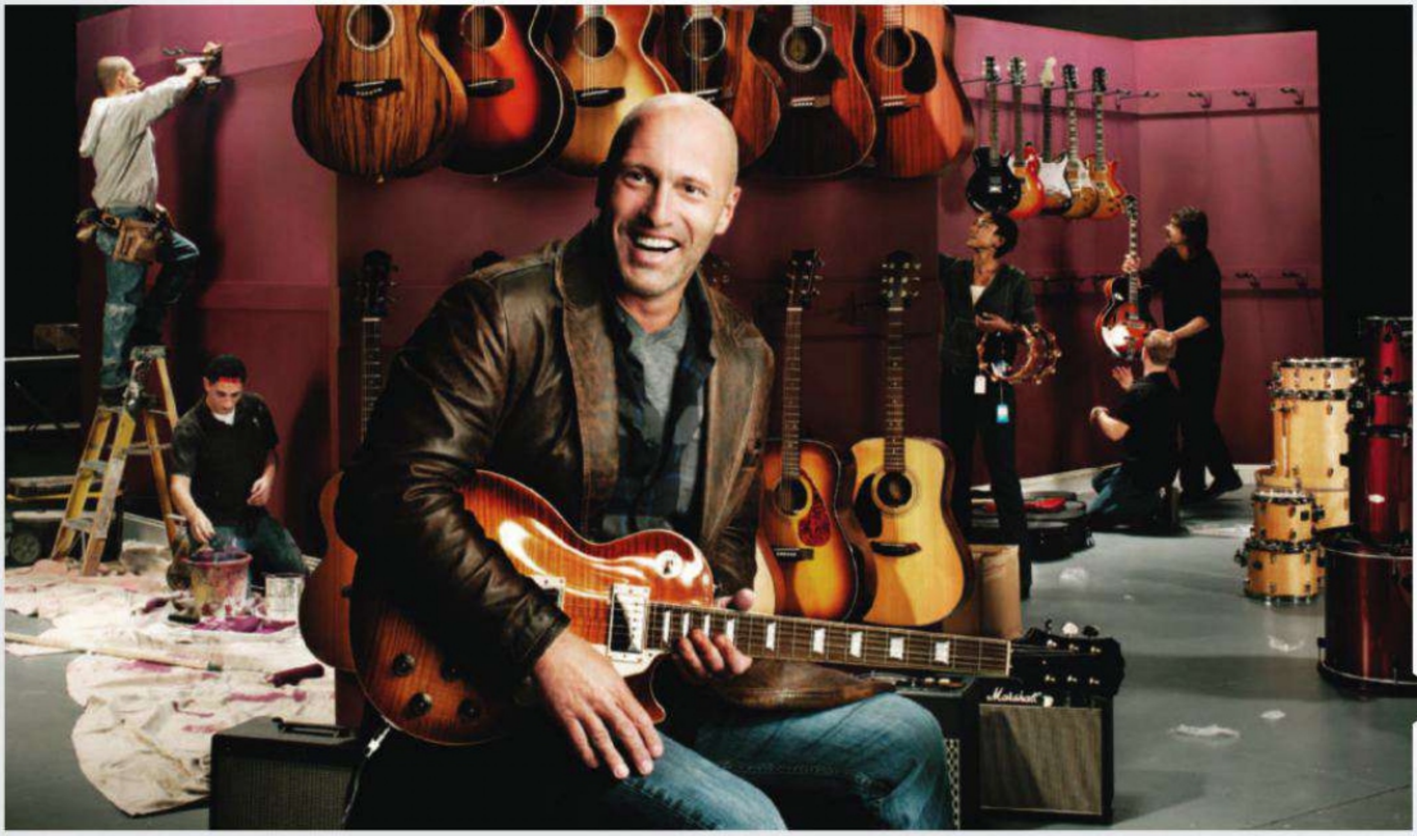
▶ **Bracing for rising prices**

The gap between yields on 10 year TIPS and Treasuries shows inflation expectations



DATA: BLOOMBERG

As Washington flooded the economy with money to fight the worst slump since the Great Depression, inflation fears helped make Treasury Inflation-Protected Securities (TIPS) the best-performing government bonds over the past two years. Now, with few signs



of higher inflation in sight, traders say TIPS may be poised to fall.

When you buy TIPS, the amount you own—and receive interest on—is adjusted annually to reflect the change in consumer prices. That's the inflation protection. You don't have to worry about deflation, because the principal can't fall below the bonds' face value. As inflation-wary investors snapped up the securities over the past two years, their prices rose sharply. TIPS returned a total of 17.2 percent from January 2008 through Jan. 25, 2011, reflecting interest income and price increases. That compares with a gain of 2.1 percent for a broad mix of Treasuries, Bank of America Merrill Lynch indexes show.

Buying TIPS today may not be as lucrative. While the economy has shown signs of recovery, prices of goods and services have not been rising nearly as rapidly as some investors feared. One reason is that unemployment is still high, which reduces the pressure on companies to increase wages—and makes it harder for them to raise prices.

The current yields on 10-year TIPS show that bondholders expect the consumer price index to increase 2.18 percentage points a year on average over the life of the debt, well above recent readings. Inflation rose 1.5 percent in 2010 and is forecast to climb 1.7 percent this year, according to a Bloomberg survey of more than 60 economists. "We're nowhere near any inflationary type of levels," says Gary Pollack, who helps oversee $12 billion as head of fixed-income trading at Deutsche Bank's private wealth unit in New York. "There's a lot of slack in the U.S. economy, especially in the labor market. It's too soon to get too bullish on TIPS."

The lack of inflation has diminished demand for TIPS. When Treasury sold a record $13 billion in 10-year TIPS on Jan.20, it received the fewest bids per dollar of debt sold since April 2009. Prices on TIPS maturing in July 2020 fell after the auction, boosting the yield to 0.99 percent as of Jan. 24 (yields rise when prices fall). At the same time, the yield on the 10-year Treasury note jumped 8 hundredths of a point to 3.41 percent, according to BGCantor Market Data.

Even facing weaker demand, the government will issue more TIPS as it increases sales of all bonds to fund the federal budget deficit, which is projected to top $1.2 trillion for a third year. Treasury will auction $120 billion to $125 billion of TIPS in 2011, after boosting issuance by 48 percent, to a record $86 billion last year, according to Barclays and Credit Suisse estimates. The increased supply may put pressure on prices, dampening returns.

Some strategists think inflation protection is still worthwhile. Commodities including corn, cotton, and crude oil have risen 24 percent since August (through Jan. 25), as measured by the Thomson Reuters/Jeffries CRB Index. U.S. consumers haven't felt much of an impact so far. Retail food costs rose 1.5 percent last year and will

Booming is
turning an early pay discount into more space for music.



Jon Haber, owner of Alto Music, was one of the very first owners to receive a Plum Card from American Express OPEN. During the recession, Jon used his Card to buy as much inventory as possible. And with the savings he got from the 1.5% early pay discount on those purchases, Jon was able to expand his business at a time when others were closing their doors.

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gain as little as 2 percent in 2011, the U.S. Agriculture Dept. estimates, though grocers from Jacksonville (Fla.)-based Winn-Dixie Stores to SuperValu in Eden Prairie, Minn., have said they plan price increases. Commodities will keep rising, according to a Bloomberg survey of more than 100 analysts and traders.

And the economy continues to pick up speed. Gross domestic product will grow 3.1 percent in 2011 and 3.15 percent in 2012, according to the median forecasts in a Bloomberg survey. The median growth forecasts in October were for 2.4 percent expansion in 2011 and 3 percent in 2012. "Where we find value [in TIPS] is as an inflation-insurance play," says Michael Pond, co-head of interest rate strategy at Barclays. He notes that the Federal Reserve remains committed to its policy of bond purchases, known as quantitative easing, to boost the economy. "The Fed is keeping its foot on the accelerator, despite the fact that data has been coming in better the past couple of months." —*Daniel Kruger*

***The bottom line** Inflation fears helped push up the prices of TIPS over the past two years. With little inflation in sight, the rally may not continue.*

Saving

Money Funds Come Out of the Shadows



▶ **Investors will soon see when a fund's market value drops below $1**

▶ **A red flag, says Vanguard's Sauter: Net asset value below $0.998**

Investors in U.S. money market mutual funds, whose shares they expect to stay steady at $1, will see something new beginning the week of Jan. 31—and it has fund companies nervous. Under rules passed last year, the U.S. Securities and Exchange Commission will disclose, with a 60-day lag, a measure of each fund's worth known as "shadow" net asset value, or shadow NAV.

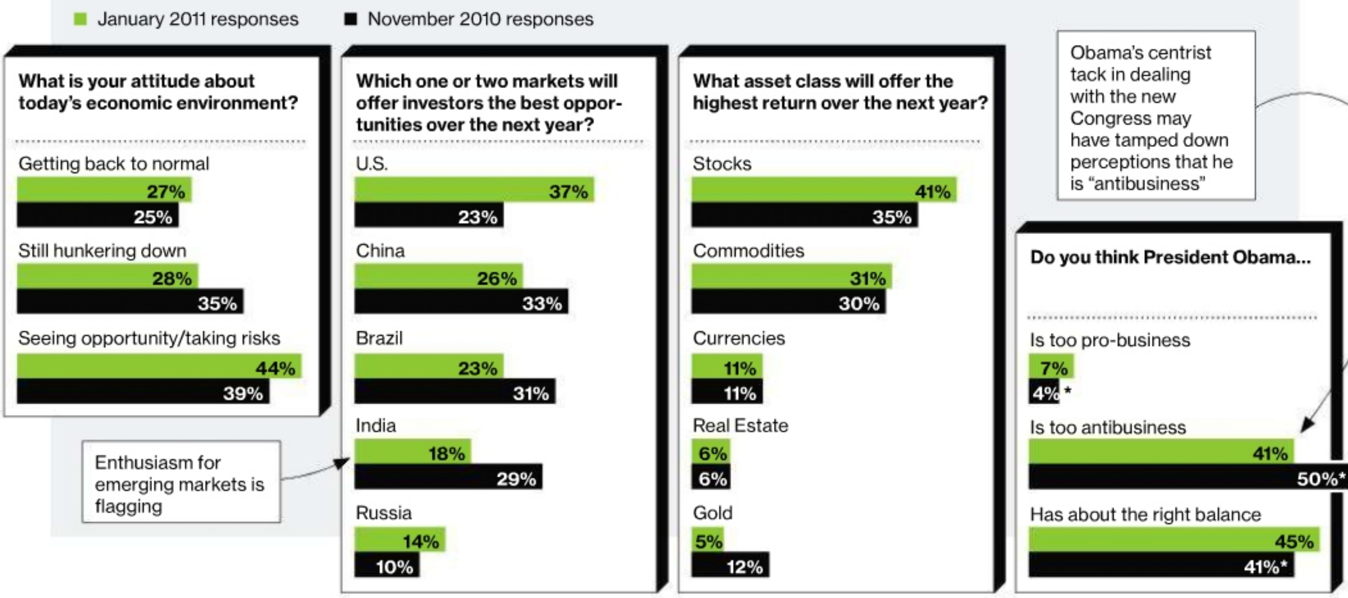
Money funds, unlike other mutual funds, book the value of holdings at the price paid for them. They also round collective holdings to the nearest penny, so even a realized loss of less than half a cent goes unnoticed. Beginning with data for last November, shadow NAVs will show holdings at market prices and to four places past the decimal, revealing fund values typically ranging from $0.9995 to $1.0005.

Since funds round to the nearest penny, a shadow NAV between $0.9950 and $1.0049 will have no impact on the $1 share price. Still, companies managing the $2.7 trillion in such funds worry some investors will panic if they see a number below $1. "They're very concerned about how the public and media will interpret the numbers," says Michael Krasner, managing editor for iMoneyNet, which tracks the industry. Late last year, **Charles Schwab** spent $132 million, and **T. Rowe Price** $17 million, to erase losses of less than half a cent in some funds so they would show $1 shadow NAVs come Jan. 31.

Polls

Investors Are Gaining Confidence

The U.S. is one of the best places to invest, and stocks will offer the highest returns this year, according to the latest quarterly poll of 1,000 investors, analysts, and traders who subscribe to the Bloomberg financial information service. —*Rich Miller and Catherine Dodge*



*SEPT. 2010 POLL. DATA: BLOOMBERG GLOBAL POLL. MARGIN OF ERROR: PLUS OR MINUS 3.1 PERCENTAGE POINTS.

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To educate consumers, fund companies such as **Vanguard** and **BlackRock** put articles on their websites and sent them to customers. Fund trade group Investment Company Institute also released a paper and held a press seminar. Their message: Don't worry–a shadow NAV slightly above or below $1 is normal. According to Krasner and Peter Crane, president of money fund research firm Crane Data, companies are right in most cases to tell investors not to fret. Shadow NAVs could reveal a small number of troubled funds. "Anything below $0.999 will be an outlier," Crane says.

The disclosure is part of a package of SEC rule changes designed to make money funds more liquid, more transparent, and safer. Regulators want to prevent the recurrence of a 2008 run on the industry that helped cripple global credit markets. On Sept. 16, 2008, the $51 billion Reserve Primary Fund closed and stopped honoring withdrawals when losses on debt issued by bankrupt **Lehman Brothers Holdings** caused its share price to fall to 97¢, an event known as "breaking the buck." (The fund has since been almost wholly liquidated.) Many more investors, unsure if other funds held debt from Lehman or other shaky U.S. banks, withdrew about $230 billion over three days.

Because money funds are the largest buyers of commercial paper, that froze the $1.1 trillion market. To ensure that companies from **General Electric** to **McDonald's** could sell commercial paper, the Treasury Dept. temporarily guaranteed money funds against additional defaults, and the Federal Reserve opened two programs to buy commercial paper directly from issuers and funds.

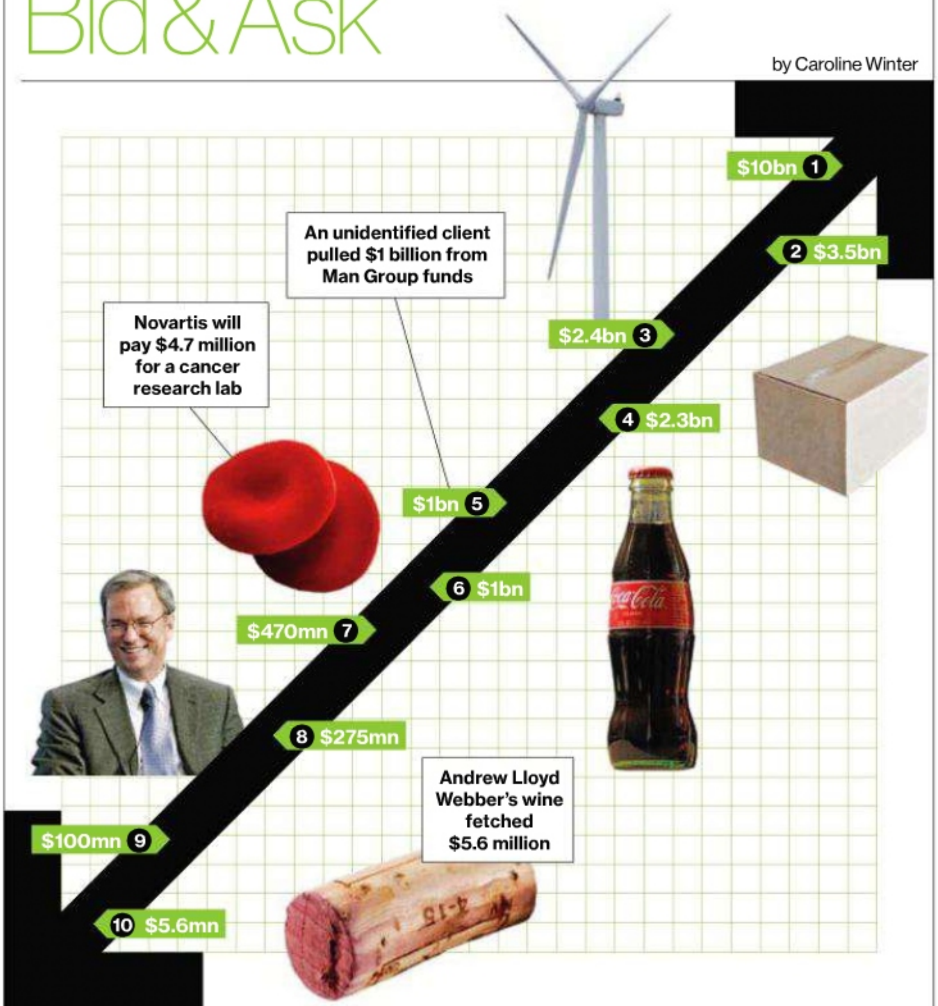
Regulators tied the panic in part to investors not knowing enough about the type and value of holdings in their funds. Now shadow NAVs are filed monthly with the SEC, which posts them on its EDGAR website. George "Gus" Sauter, Vanguard's chief investment officer, says barring a normal dip after an interest rate hike, a shadow NAV below $.998 is a red flag. Says Krasner: "Look at the info, read the manager's explanation. If you're still concerned, call them. If you're not comfortable with the answer, move your money." B —*Christopher Condon*

***The bottom line** Fund companies worry investors will overreact if they see money funds' "shadow" NAVs dip slightly below $1 a share.*

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Bid & Ask

by Caroline Winter



1 **Intel** is adding $10 billion to its stock buyback program, bringing the total authorized to $14.2 billion. The company ended 2010 with $21.5 billion in cash, thanks in part to a boom in corporate technology spending.

2 **RockTenn** agreed to buy Smurfit-Stone Container for $3.5 billion, a deal that would create North America's No. 2 containerboard producer.

3 Spain's biggest utility, **Iberdrola**, will pay $2.4 billion for 99.68 percent of Elektro Eletricidade e Servicos, which supplies power in São Paulo, Brazil's most populous state.

4 Mexico's No. 2 Coca-Cola bottler, **Embotelladoras Arca**, agreed to merge with Grupo Continental in a $2.3 billion stock transaction.

5 No longer wanting exposure to European stocks, an unidentified investor pulled $1 billion from funds run by **Man Group**, the world's largest publicly traded hedge fund firm.

6 **Amgen**, the world's No. 1 biotech company, will pay up to $1 billion for BioVex, a maker of experimental cancer drugs.

7 Switzerland-based **Novartis** will pay about $470 million for Genoptix, a California lab specializing in diagnosing bone marrow, blood, and lymph node cancers.

8 **Columbia University** in New York City is selling $275 million of tax-exempt municipal debt to finance construction projects.

9 **Google** is granting $100 million in stock and options to exiting CEO Eric Schmidt, 55, who will become executive chairman in April. Schmidt helped Google grow to $29.3 billion in revenue from less than $100 million in 2001.

10 A **Sotheby's** sale of 746 lots of wine belonging to Andrew Lloyd Webber fetched $5.6 million in Hong Kong. The composer has collected fine vintages since he was a teen.

I'LL TAKE IT FROM HERE



The old triumvirate: Brin, Page, and Schmidt in Sun Valley, Idaho, last summer

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Google's once and future CEO, Larry Page, on his plan for growth—and the star deputies who have to make it happen

By Brad Stone
With Peter Burrows
and Douglas MacMillan

Every Monday afternoon at the Googleplex in Mountain View, Calif., more than a dozen of Google's top executives gather in the company's boardroom. The weekly meeting, known as Execute, was launched last summer with a specific mission: to get the near-sovereign leaders of Google's far-flung product groups into a single room and harmonize their disparate initiatives. Google co-founder Sergey Brin runs the meeting, along with new Chief Executive Officer Larry Page and soon-to-be-former CEO Eric Schmidt. The unstated goal is to save the search giant from the ossification that can paralyze large corporations. It won't be easy, because Google is a tech conglomerate, an assemblage of parts that sometimes work at cross-purposes. Among the most important barons at the meeting: Andy Rubin, who oversees the Android operating system for mobile phones; Salar Kamangar, who runs the video-sharing site YouTube; and Vic Gundotra, who heads up Google's secret project to combat the social network Facebook. "We needed to get these different product leaders together to find time to talk through all the integration points," says Page during a telephone interview with *Bloomberg Businessweek* minutes before a late-January Execute session. "Every time we increase the size of the company, we need to keep things going to make sure we keep our speed, pace, and passion."

The new weekly ritual—like the surprise announcement on Jan. 20 that Page will take over from Schmidt in April—marks a significant shift in strategy at the world's most famous Internet company. Welcome to Google 3.0. In the 1.0 era, which ran from 1996 to 2001, Page and Brin incubated the company at Stanford University and in a Menlo Park (Calif.) garage. In 2001 they ushered in the triumphant 2.0 era by hiring Schmidt, a tech industry grown-up who'd been CEO of Novell. Now comes the third phase, led by Page and dedicated to rooting out bureaucracy and rediscovering the nimble moves of youth.

Although Google recently reported that fourth-quarter profits jumped 29 percent over the previous year, its stock rose only 13.7 percent over the past 12 months, disappointing investors and lagging the Standard & Poor's 500-stock index. Google is being outpaced by rivals such as Facebook in social networking. In 2010, Facebook served up more display ads than either Google or Yahoo!—and was visited by more U.S. Internet users. And Apple is setting the pace in mobile computing, with beloved products that use a proprietary operating system that can be closed off to Google's services if the company so chooses.

On top of all that, there are antitrust inquiries in Washington and Europe, the defection of some top Google executives for opportunities elsewhere, and perhaps the most serious rap against the company: that its loosely organized structure is growing unwieldy and counterproductive.

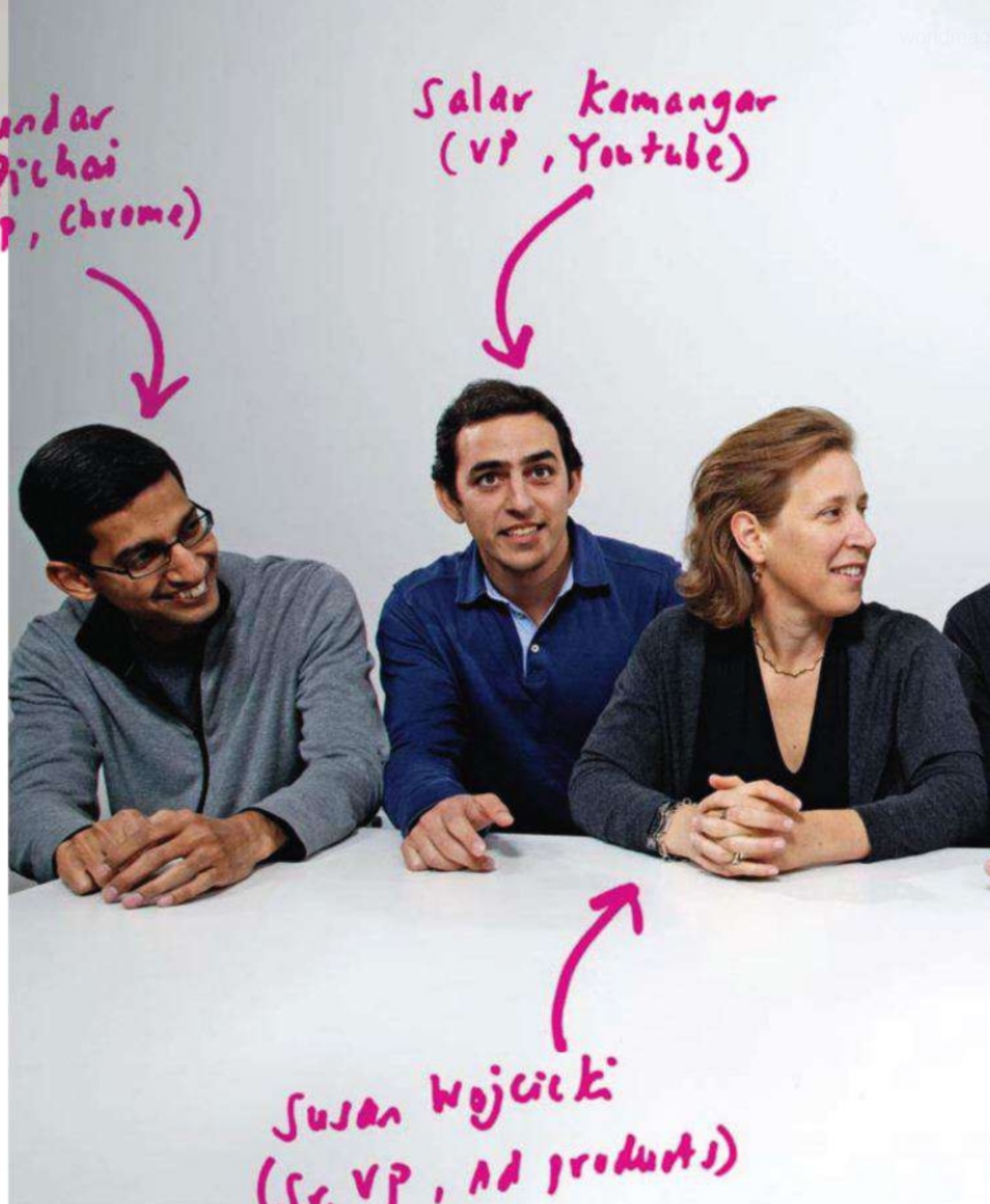
The creative chaos inside Google's halls—a decentralized jungle of innovation, as one prominent venture capitalist puts it—once empowered employees to make bold moves, such as creating Gmail, the search-based e-mail system. Other than Android, the culture has recently produced a string of flops, such as Google Buzz, a Twitter clone, and Google Wave, a wonky service that let people collaborate online.

Page doesn't explicitly blame those missteps on the company's loosely knit management or the famous troika at the top. Yet he concedes, "We do pay a price for [shared decision making], in terms of speed and people not necessarily knowing where they go to ask questions." His elevation to CEO, he says, "is really a clarification of our roles. I think it will help with our speed."

Former Google employees are encouraged. "Larry is a visionary, the kind of person that inspires people to

MATTHEW STAVER/BLOOMBERG

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do more, be better, reach farther," says Douglas Merrill, Google's chief information officer until 2008. "He would walk around the engineering department and, with just a word or two, guide or redirect projects and leave the developers feeling great about the coaching."

The Google alums also acknowledge that Page is not a natural chief executive. An introvert, he avoids public speaking and hates having a strict daily schedule. He's no frontman—and that's where the deputies at the weekly Execute meetings come in. They'll increasingly become Google ambassadors to the world. Page says one of his goals is to take the decisive leadership style they have shown within their product groups, spread it across the company, and apply it to major decisions. "We've been inspired by a lot of the people who have been operating with more autonomy and clear decision-making authority," he says.

To get a sense of the emerging leaders at the technology giant, *Bloomberg Businessweek* spent time with six of Google's top product people, from one of the chiefs of the advertising technologies unit, to the head of the new Chrome operating system, to one of Google's czars of search. These deputies don't encompass all of Google's top talent, but they do have Larry Page's ear, and in some sense they represent the company's future. The executives—some of whom have been with Google from the beginning—made it clear that they still believe in the company. Google, they say, can succeed in markets where it has so far shown little aptitude. Together, their mandate is to help the company move more quickly and effectively—to keep it from becoming yet another once-dominant tech company that sees its mantle of innovation stolen away by upstarts.

The Field General

Google periodically invites celebrities to give talks at the Googleplex. Last May, Conan O'Brien came by. Interviewing the comedian in front of several hundred employees was not Schmidt, Page, or Brin but Vic Gundotra, the engineering vice-president and one of Google's fastest-rising stars. Gundotra, 41, is known as a smooth operator. Not this time. For nearly an hour, O'Brien derided him and his attempts at humor. "[This is] the most condescending man I've ever met," O'Brien said. The YouTube video has been viewed more than a million times.

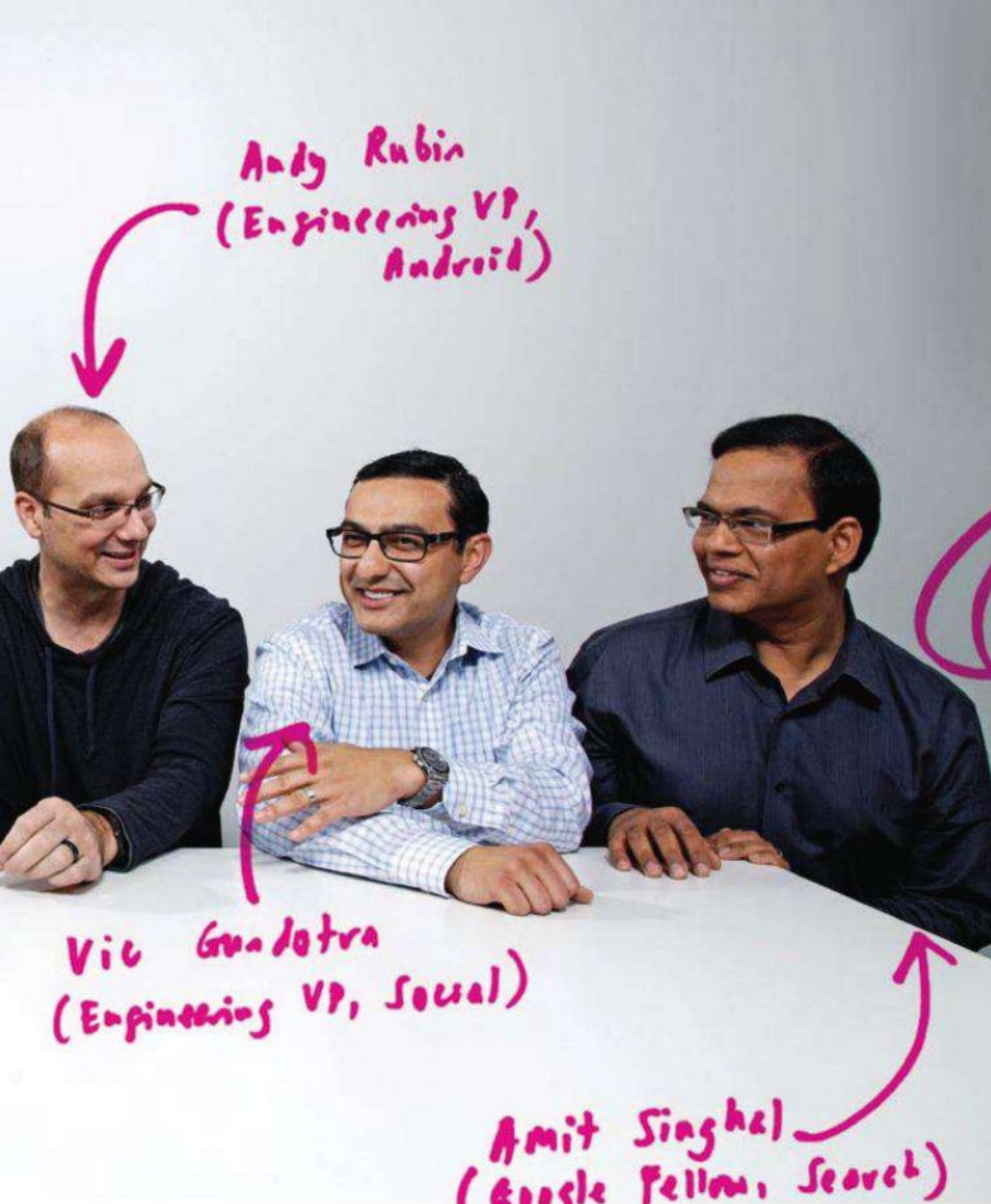
Gundotra stands out at Google for more than his ability to absorb ridicule. He's Google's field general on two fronts: against Apple for the hearts and minds of mobile developers and in a new conflict with Facebook to control the next set of social connections on the Web.

That's a measure of how much has changed since Gundotra joined the company in 2007. He was hired away from Microsoft at a time when that company was considered by Googlers to be their biggest rival. As Microsoft's "chief evangelist" in the 1990s and early 2000s, Gundotra reached out to software makers and was considered "something of a legend," according to Ashish Gupta, a former Microsoft marketing executive, for helping to persuade them to write programs for computers running Windows and its emerging cloud services framework, dubbed .net.

Gundotra's defection was inspired by his young daughter. Over lunch in 2005, he says, a question came up and she asked why he didn't just "Google" the answer. "It was a defining moment," he says. "I like to have the wind at my back." He came into the new job, colleagues say, like a tornado whipping through a Midwestern town—making the rounds of the Googleplex, asking questions designed to provoke, such as "What were Google's revenues last year?" Most staffers had no clue. Even his allies say the initial relationship was rocky. "Google and Vic had to feel each other out," says Matt Waddell, Gundotra's chief of staff.

Schmidt and the co-founders soon put Gundotra in charge of Google's effort to create applications for mobile devices. Under his watch, Google cranked out a much faster mobile search engine, a more useful Google Maps, and Google Goggles, which lets phone owners get information on things around them by pointing the camera at them. He also became point man for dealings with software developers, racing Microsoft and Apple to persuade programmers to write for Google's cloud services and its Android platform for phones.

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PHOTOGRAPH BY ROBYN TWOMEY FOR BLOOMBERG BUSINESSWEEK

In Silicon Valley, that kind of evangelism usually involves firing insults at the competition. While that hasn't typically been Google's style, Gundotra hasn't shied away. As he says, "It's an art to create a sense of inevitability." In a keynote speech at a Google event for developers last year, he even took aim at Steve Jobs and "a draconian future where one man, one company, and one device would be our only choice ... That's a future we don't want."

Gundotra has also sparred with Apple behind the scenes. As Android became a threat to Apple in 2008, Apple began resisting Google's claim to valuable location data gathered whenever an iPhone owner used Google Maps. His negotiations with Apple marketing chief Phil Schiller grew so heated that Schmidt and Steve Jobs had to intervene to settle the matter, according to two people familiar with the incident. (Apple announced earlier this year that it had developed its own location-monitoring system. Gundotra and Schiller both declined to comment on the incident.)

In October, Gundotra assumed joint command of a secret SWAT team to add social elements to Google's array of services. The company hopes the effort will help it combat Facebook and rebound from botched social networking forays such as Buzz and OpenSocial, a failed 2007 attempt to forge an alliance of social networks other than Facebook. Gundotra and a former Yahoo executive, Bradley Horowitz, run the effort from a shared office in Building 2000 on the Google campus.

Gundotra won't say much about the initiative. Two sources familiar with it, who asked not to be named because the project is not yet public, confirm that it is tentatively called Google +1 and that it is designed to cull data about relationships among users from current services such as Gmail and YouTube. Google will then let users share material through those connections, while using the information to make other products more social. Search results may be skewed toward pages that your friends found useful—for instance, a Google Maps query for nearby Italian restaurants could return one that was positively reviewed by someone you know.

Gundotra won't comment, but Page hints that Google's social network plans will offer more refined privacy protections. "You see tremendous controversy around [social networks] today, with people being worried: Am I sharing stuff with the right people or not?" Page says. "I think there's a long, long way to go to make these systems do what people need."

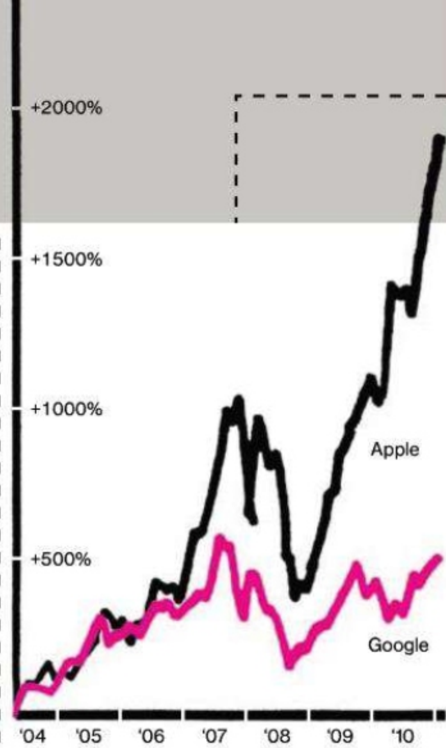
The Inventor
Andy Rubin is a tinkerer, as adept at creating mechanical marvels in his home as he is writing the software that runs tablets and mobile phones. His latest invention, produced with several Google colleagues, is "Java the Bot," a wheeled two-armed robot that can roll up to an espresso machine and perform all the steps needed to make a decent cup of coffee. (It's still in development.) "From a computer science perspective, it's an unsolved problem," he says, emphasizing that he has no plans to put Starbucks' baristas out of business.

Since Google acquired his eight-person startup, Android, in 2005, Rubin has expended most of his entrepreneurial energy within the Googleplex. His Android platform has pulled off arguably the fastest land grab in tech history, jumping from also-ran to market leader with 26 percent of the smartphone market, vs. 25 percent for iPhone, according to research firm ComScore. (BlackBerry was first, with 33 percent, but is losing ground.) Android's success has made Rubin a model inside Google for how executives can run units autonomously. "We need even more of those," Page says of Android.

Because Rubin's mission to create a mobile operating system was so distinct from the rest of Google's goals, he was given unique leeway in managing his division. He can hire his own team and even controls the landscaping around his office building, which he decorates with supersized ornaments of the desserts (éclair, cupcake) that give versions of Android their name. Google "did a very good job of giving us autonomy," Rubin says. "We can move really, really quickly.".

Rubin has his share of challenges. His best partner in the U.S., Verizon Wireless, goes into business with Apple on Feb. 10, when it starts selling the iPhone. That could slow sales of Android phones in the U.S., though Rubin prefers to

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Stock price gain since Google IPO

emphasize success around the world and in places such as Japan. "I don't think any specific carrier in any one region is a big game changer for us," he says.

Inside Google, Rubin has been expanding his domain. Android software powers the company's fledgling (and thus far poorly reviewed) Google TV. A new version of Android called Honeycomb will run tablet devices made by Motorola and others that are designed to compete with the iPad.

He has also assumed leadership of digital music. The company's efforts in the field were long marked by overlap, with different divisions, such as search and online storage, working on separate projects. Rubin felt Android needed better music features to compete with the iPhone, so he wrested away that project last year, according to a former executive, and is now working with a former YouTube lawyer, Zahavah Levine, to acquire licenses from the four major music labels. His group has developed a service that will let users upload their music collections to Google's servers and then synchronize them with any mobile device, according to three people familiar with Google's plans. The offering could be unveiled as soon as next month. Representatives of the music labels with knowledge of the talks caution that no deals have been signed. As one of them says, however, Google's music effort has more credibility now that Rubin is running it.

The Veterans

Page, Brin, and Schmidt deserve much of the credit for Google's success—but not all of it. "The key to making Google viable was the people they hired in the early days, many of whom are still there and are super-rich," says Steven Levy, author of the forthcoming book *In the Plex: How Google Thinks, Works, and Shapes Our Lives*. "They are part of the inner circle that makes the big decisions."

Salar Kamangar and Susan Wojcicki fit into that group. Kamangar, employee No. 9, runs YouTube from an office 30 miles north of Google's campus. Wojcicki, recently promoted to senior vice-president, runs a 100-person team focused on the future of advertising. Google's first headquarters was her garage—she rented it out to Brin and Page in the early years and later became employee No. 16. A decade ago, Kamangar and Wojcicki shared an office and, often, a laptop power cord.

Kamangar's ascent has been particularly remarkable. An Iranian-born Stanford graduate with a degree in economics, he started as Page and Brin's factotum, then became the driver behind AdWords, the system that ranks ads alongside search results based on the price advertisers pay and the performance of each ad. The system accounts for the vast majority of Google's $29.3 billion in annual sales and may be the largest generator of revenue ever devised on the Web.

Kamangar was also a force behind Google's $1.6 billion acquisition of YouTube in 2007. Under his stewardship, the site—which generates more than 2 billion video views per day and doubled its revenues in 2010—is finally becoming a retort to those who call Google a one-trick pony. Citigroup analyst Mark Mahaney expects total sales on YouTube to exceed $1 billion for the first time in 2011. Kamangar "has a gift of monetization," says David Hirsch, managing partner of investment firm Metamorphic Ventures and a former Google sales executive.

Recently, Kamangar shifted his approach to expanding the YouTube catalog. Instead of acquiring professional shows from cable and broadcast outlets (which wasn't going well), he's pursuing high-quality amateur material. "We don't think it made sense to try to compete with TV on getting the same content people are already paying subscription fees for," he says. "We want to be the platform for the next set of channels."

Wojcicki's career has mirrored her colleague's. A Harvard graduate with an MBA from UCLA, she was a primary creator of AdSense, the partner program to AdWords that syndicates Google's search ads across the Web. She's also close to Google's founders—Brin is married to her sister—and she helped drive the acquisitions of the display-ad pioneer DoubleClick, for $3.1 billion, in 2007 and mobile advertising firm AdMob in 2009, for $750 million.

Now her group is plotting Google's next moves in advertising. She's developing tools that meld offline and online commerce, such as a new service that lets users search the inventories at local stores. Mindful of the threat posed by Groupon, the coupon site Google tried and failed to acquire for $6 billion late last year, she is working with Google's local and e-commerce teams to develop ad services for local businesses. Like many of her colleagues, she is also thinking of ways that ads on Google can get more social. "Everything we do with search we should do with ads," she says.

The Loyalist

Over the past few years, Google has lost a stream of executives to startups, venture capital firms, and, most embarrassingly, Facebook. Sundar Pichai bucked the trend. A vice-president for product management in charge of the Chrome browser, Pichai, 38, was recently courted by Twitter, the hot microblogging startup. Pichai won't say whether Google sweetened his compensation, but he confirms that he's not leaving. "I'm staying. I'm happy here," he says. "I look at this as a life journey that I've been on for a long time."

A native of Tamilnadu, India, who graduated from Stanford, Pichai joined Google in 2004 from the semiconductor-equipment firm Applied Materials. His first job was to develop the browser toolbar that put Google search at the top right corner of Internet Explorer and Firefox, and it spawned a series of ever more ambitious projects. Since the toolbar increased the frequency of Web searches, Pichai and the Google founders decided the company should develop

"WE NEED EVEN MORE OF THOSE"

—Page, on Android's success

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"YOU'VE GOT TO KEEP SCRATCHING YOUR HEAD, WHY DO THEY STILL HAVE CHROME?"

—Blogger Danny Sullivan, on Google's other operating system

its own browser with search baked in. Released in 2008 and based on open source code, that browser, Chrome, is now the choice of 10 percent of Internet users around the world, according to tracking firm Net Applications.

Chrome's success persuaded Google to go even further. Pichai is now also in charge of developing an operating system with the same name, one that will allow a new generation of cheap, low-power computers to boot up instantly. All these PCs do is connect to the Web. In December, Pichai's team unveiled the first fruit of that project, an unremarkable laptop called Cr-48. The Cr-48 received generally negative reviews from critics who were more accustomed to fancy and feature-rich computers.

To some, the Chrome OS project represents Google's identity crisis—and the inability of its top decision makers to marshal resources efficiently and kill redundant projects. After all, the company already has a successful operating system—Android—and the two projects don't mesh. Andy Rubin's software requires applications to be downloaded and run from a device's local memory. Chrome, on the other hand, runs applications that sit in the cloud and use a new Web standard called HTML5. Rubin and Pichai "both have huge projects that are being propelled in part because Google values their talent," says Danny Sullivan, editor of the blog Search Engine Watch. "At this point, though, you've got to keep scratching your head. Why do they still have Chrome?"

Pichai sees no such conflict and says he's not building software to suit the conventional wisdom. "Some things give you an easier way out of the door because you are doing something that fits into the hot category of the moment," he says. "I want to know that we are building something that people will find useful." While the upcoming range of tablets and set-top boxes all run Android, Pichai isn't forfeiting that fight, either. "We are building a software layer which will work across every type of hardware over time," he says.

That suggests Rubin and Pichai are direct competitors. Both of them insist, however, that while they are approaching the same problem with different visions, they share a "deep mutual respect," as Pichai says. "I don't think you can do things like this outside of Google," he says.

Lord of the Engine Room

Last October, Google's effort to streamline and accelerate decision making reached its most important division—search. Marissa Mayer, one of the group's longtime leaders, left search to lead Google's effort to go after the growing market for local services. The search engine, which had been run by two groups, products and engineering, was unified under the control of former Amazon.com executive Udi Manber.

Manber shuns the spotlight, so representing search often falls to his deputy, Amit Singhal. Singhal, 42, an excitable and expressive search scientist from Jhansi, India, became Google employee No. 190 in 2000 and has for the past decade run the ranking and relevancy algorithms—the engine room that for 12 years has made Google search outrun its rivals. Singhal works from Building 43, the geeky hub of the world's geekiest company, where a real spaceship hangs from the ceiling and employees can be seen on their breaks playing the complex fantasy card game Magic: The Gathering.

Singhal insists that even a division as large as search, with thousands of engineers, is responding to Page's call to accelerate the pace of innovation. "Search quality has gone up at a speed which I have never witnessed in my career," Singhal says of the last few years.

The search engine, like much else at Google, has been under attack recently. Marketers and some technology industry bloggers say it is returning more links to spammy sites such as cheaply produced content mills and user-generated question-and-answer pages. "Searching Google is now like asking a question in a crowded flea market of hungry, desperate, sleazy salesmen who all claim to have the answer to every question you ask," wrote entrepreneur Marco Arment in a widely read post on his blog earlier this month.

While Singhal disputes this sentiment, Google has recently moved to address the complaints. A blog post on Jan. 21 from Matt Cutts, who shares an office with Singhal, pledged to penalize companies that churn out pages with low-quality content and then try to fool Google's technology in order to appear prominently in search results. When *The New York Times* exposed a fraudulent eyeglass merchant in December that was featured high in Google search results, Singhal assembled a team that in three days came up with a batch of "signals," or indications that could better discriminate between dishonest merchants and legitimate ones. He says such sellers are now heavily penalized and nearly invisible in Google's results.

If there's a broad call at the company to integrate social networking features, Singhal hasn't quite heard it. He seems skeptical about whether social data can make search results significantly more relevant. If he's searching for a new kind of dishwasher, he argues, his friend's recommendations are interesting, but the cumulative opinion of experts manifested in search results is much more valuable. He notes that Google already integrates content from Twitter and says social networking data is easily manipulated. Can social context make search more relevant? "Maybe, maybe not. Social is just one signal. It's a tiny signal," he says.

How social media will and won't change Google's world is an ongoing conversation at Google's weekly Execute meetings—and it underscores Larry Page's biggest problem as Google's new CEO. Page values strong, idiosyncratic leaders who know their domains and have their own aggressive agendas. All these rising stars have to work together. The mobile team has to coordinate with the nascent local and e-commerce groups. Rubin's app-based Android vision of the future has to square with Pichai's push for the wide-open Web of Chrome OS; and Singhal's search division has to find common ground with Vic Gundotra and the new czars of social. Can they integrate their plans while satisfying Larry Page's need for speed? At some point, Page may have to dispense with the philosophical discussions, put some limits on the open atmosphere of geeky experimentation, and make some tough decisions. It's not very "Googley." But it's the central challenge of Google 3.0. B

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The Last Game?

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A labor dispute between the National Football League and its players is threatening to bleed billions in revenue—and possibly cancel the 2011-12 season

By Paul Wachter, Aaron Kuriloff, and Ira Boudway

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Eric Grubman's brand of football isn't meant for *SportsCenter*'s highlight reel.

Yet it tends to be fan-friendly in its own way. On a November day at the National Football League's Manhattan offices, Grubman—a former Goldman Sachs investment banker who is the NFL's executive vice-president of business operations—shuttles between meetings about foreign TV deals, overseas games, and stadium improvements. Along the way he's often looking out for the customer. He wants universal Wi-Fi access at the stadiums. ("You could order food right over your phone," he says.) He's also in favor of in-stadium broadcasts of the footage game officials use to review challenged plays. ("The fan at home sees every angle of the disputed calls," he says. "Why shouldn't the fan at the game?")

Grubman, however, may soon become the bane of football fans everywhere. As the league's top money man, reporting directly to Commissioner Roger Goodell, he's at the center of a labor dispute that could make Super Bowl XLV the last NFL game for a long time. While the Feb. 6 matchup between the Green Bay Packers and Pittsburgh Steelers is the biggest date on the football calendar, most players and team owners have their eyes fixed on Mar. 3. That's when their collective bargaining agreement expires. Until a new one is in place, there likely won't be any more games, raising the prospect of a lost 2011-2012 season.

Grubman, 52, dresses casually, at least by the NFL's corporate standards. Today he's wearing a cardigan and slacks, and his black hair, streaked with silver, is swept back. The overall effect suggests a New England professor more than a U.S. Navy officer-turned-investment banker, which is Grubman's actual career path.

When he describes the standoff between owners and players, however, Grubman is all business. Over a light lunch at The Huddle Café, the NFL employee canteen, he explains that the problem, as he sees it, is one of labor myopia. "The players are too concerned with how you divide the pie," Grubman says, "while we're trying to grow the pie so that there's more money for everybody." As he delves into the issue, though, he concedes a larger point. The owners opted out of the current collective bargaining agreement because, he says, "They made a bad deal. They realize it now."

The "bad deal" went down in 2006, when the owners voted 30-2 in favor of the fifth extension of a labor agreement first enacted in 1993. The new deal raised the salary cap, allotted nearly 60 percent of the league's total revenues to player salaries, and inaugurated a revenue-sharing plan in which the 15 top-earning teams subsidize the 17 less profitable ones. What made sense in the boom times of 2006 soon proved onerous. In May 2008, the owners unanimously voted to pull out of the two-year-old agreement, setting the clock ticking for Mar. 3.

With time now running out and Grubman and his colleagues negotiating in private with NFL Players Assn. Executive Director DeMaurice Smith, details of the talks remain sketchy; Grubman declines to fill them in. Smith, however, has highlighted two particular concessions sought by the league and its owners. First, they're seeking to decrease the players' share of total revenue. Second, they're asking for two games to be sliced from the four-game preseason and added to the regular season's schedule.

Both ideas are hugely unpopular with the union. "We give back $1 billion," says NFLPA President Kevin Mawae, "and increase our risk of injury by playing two additional games." Meanwhile, the two sides are fighting over what a potential lost season, with its billions of dollars in forfeited salaries and revenue, should be called—and who would be to blame. "Work stoppage" is the term the NFL prefers. "Lockout" is what the players call it. After all, "it's the owners who opted out of the contract," says George Atallah, the NFLPA assistant executive director. "The players want to play." The owners say missed games are inimical to their interests, too.

In mid-September, just before the kick-off of the season's first game, a Thursday night contest between the Minnesota Vikings and New Orleans Saints, players from both teams marched to midfield and raised their index fingers in unison—an unusual display of camaraderie for men paid to knock each other senseless. Three days later, on the NFL's opening Sunday, the ritual was reenacted in stadiums from Orchard Park, N.Y., to Seattle. In Houston, four-time league MVP Peyton Manning led his Indianapolis Colts to midfield to join in with the Texan players.

The demonstrations were orchestrated by Saints quarterback Drew Brees and Vikings lineman Steve Hutchinson, the union leaders for their respective teams. "Once they decided to do that," Arizona Cardinals kicker and union rep Jay Feely remembers, "it was really incumbent on all the others players around the NFL to back them."

While these were the season's last on-field references to the dispute, NFL locker

PREVIOUS SPREAD, FROM LEFT: MIKE ROEMER/AP PHOTO; GEORGE GOJKOVICH/GETTY IMAGES; THIS SPREAD: JOE ROBBINS/GETTY IMAGES
DATA: NATIONAL FOOTBALL LEAGUE; NATIONAL FOOTBALL LEAGUE PLAYERS ASSN.

Games of Chance

Putting the NFL's looming labor stalemate into perspective. —Patrick Cain

NHL
NFL
NBA
MLB

1965 | 1966 | 1967 | 1968 | 1969 | 1970 | 1971 | 1972

1968 (NFL): NFL players demand pension reform. After a one-week strike, a collective bargaining agreement is reached

1972 (MLB): Major League Baseball's first strike begins over pension and arbitration concerns

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rooms have been doubling as union halls throughout the season. On a Thursday afternoon in December, linebacker Scott Fujita gathered his Cleveland Browns teammates after practice for a meeting. Where players would normally split into position groups and talk about blitz packages and coverage schemes, Fujita, a member of the NFLPA executive committee, spent 90 minutes fielding questions about bargaining proposals, savings accounts, and health-care plans.

"There are a lot of guys on our team who are expecting babies in March and April," says Fujita, a nine-year veteran with a mop of brown hair and a degree in political science from the University of California at Berkeley. "They were curious about how the lockout's going to affect them." Fujita and the union reps on the league's 32 teams have been handing out the same advice: Start saving now. "We're really harping on everyone," he says. "Put that money away." He even hands out direct deposit slips.

The union has put money from dues and royalties into a fund that amounts to about $60,000 per player. "It won't be anything compared to what they would be earning if they were playing," says Feely. "But it would be some cash to pay everyday bills." For many of the league's 1,900 players, it could be quite helpful. The average NFL career lasts 3.5 years. While the average NFL salary is $1.9 million, that number is skewed by the hefty paychecks of Peyton Manning and other stars. The median salary is $770,000, and for the players on the margins—those fighting to keep a roster spot from year to year—almost any offer from the owners beats staying home. "Guys like that, to be honest, are the majority of our locker rooms," says Fujita. "Someone is going to come to them at some point and try to get them to flip sides. But I know the guys in the locker rooms I've been around, and that's not going to happen. They understand that if we fold and accept the deal currently on the table, it's going to be devastating for players forever."

In order to keep the rank and file together—to fight what Feely calls their "natural, selfish" inclinations—the union representatives appeal to their sense of history. After two strikes in the 1980s, lawsuits brought by players such as Freeman McNeil and Reggie White in the early 1990s paved the way for the free agent rights that NFL players enjoy today. "The players and the owners have it pretty good right now," says Baltimore Ravens cornerback Domonique Foxworth. "A lot of people gave up a lot of money and several seasons and a lot of pain and anguish for us to get to where we are right now," says Foxworth, who was tapped to be a union rep in 2006 by veteran Denver Broncos receiver Rod Smith. "You're carrying a torch. ... We refuse to give back on our watch."

It's only possible to talk about NFL team revenue in the aggregate. With the exception of the publicly owned Green Bay Packers, franchises don't release financial statements. The Packers posted an operating profit of $9.8 million in the fiscal year that ended on Mar. 21, 2010, down from $20.1 million in the previous one. (However, the team's net income rose 30 percent, to $5.2 million.) The Packers' CEO has blamed the decline on rising salaries, but players say a full picture of the league's fortunes will only come when each team opens its books. "It's one-thirty-second of the financial information we've requested," says the NFLPA's Mawae, a 16-year veteran who retired last year. Jay Feely points to the National Basketball Assn.—another league in the throes of a labor standoff—which has turned over its books to the players. "They are having legitimate issues with money, and so they turned over their financials," he says. "The NFL won't do that."

According to Grubman, such calls for financial transparency are a ploy. "The players already have audit rights to the revenue. What they're looking for is information on the costs," he says.

"If we fold and accept the deal currently on the table, it's going to be devastating"

Scott Fujita, Cleveland Browns



The Average NFL Player

Don't let Brett Favre fool you. Most NFL careers are much shorter and a lot less sweet



Owners refuse NFL players' demands for guaranteed salaries. A six-week strike ensues

An eight-day strike by the Major League Baseball Players Assn. cuts spring training short

1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980

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"They want to uncover stuff like private jet fees or other expenses that they can use to embarrass the owners with the public." The players insist they simply want a full accounting of each team's balance sheet. "But that's not relevant," Grubman continues. "The league doesn't ask to see the players' tax returns. Or those of their agents—I'd *love* to see those."

One thing everyone can agree on is that a lost season would be a financial disaster. Even if a deal is struck by Sept. 1, in time for the regular season, the NFL could lose up to $1 billion—including up to $100 million per weekend at the gate for canceled preseason games. Sponsors, who plan their ad campaigns more than a year in advance, already have safer options for their budgets, starting with the 2012 Summer Olympics.

The NFLPA says a lost season could cost every NFL city $160 million in jobs and revenue. The 1,900 players would lose a combined $4.5 billion in salary and bonuses, while the league concedes it might have to impose pay cuts for its own 1,000-odd employees. Then there are the thousands of sports bars that will struggle to pay the rent with pro bowling on TV during Sunday afternoons. "Our business would be one-third depleted just from the Packers not playing," says Jerry Watson, owner of Green Bay's Stadium View Bar & Grille.

If negotiations end up coming down to a game of chicken, the deep-pocketed owners are much better prepared than the players to prevail. They're sitting on $900 million—a potential "lockout fund," says Atallah—comprised, in part, of life insurance and pension payments withheld since the salary cap expired last March. (Such withholdings comply with the current collective bargaining agreement.)

The league's TV deals with the networks also pay more than $4 billion for next season, even if not a single game is played. (For any canceled games, the broadcast companies—CBS, NBC, ESPN, Fox, and DirecTV—would receive credits for future contests.) The NFL's general counsel, Jeff Pash, has compared the arrangement to "borrowing on a home equity line," but the players union describes it as an insurance plan for a lockout. Last month, the NFLPA filed a complaint against the league over the TV agreement that will be adjudicated by a federal-court-appointed special master, who will also decide a separate complaint alleging that league owners colluded to restrict player salaries.

"A lot of people gave up a lot of money and several seasons and a lot of pain and anguish for us to get where we are"

Domonique Foxworth, Baltimore Ravens



However, the players may have legal means to fight a lockout. According to former player and current power agent Tom Condon, the co-head of Creative Artists Agency's football unit, the NFLPA could abandon its status as a union. Players could then sue, arguing that the NFL's 32 teams are independent businesses colluding to restrict players' pay. Just last year the U.S. Supreme Court argued that, for licensing purposes, the teams should indeed be treated as separate entities. "If the owners make the determination to proceed with the lockout," says Condon, "you can anticipate the players responding by trying to get an injunction." It's a move that has proven effective in the past. After a strike broken by replacement players, in 1987, the NFLPA decertified two years later. The move triggered approximately 20 lawsuits—including the one that helped create free agency in 1993.

In a sense, the rise in NFL team fortunes over the past two decades can be traced through the career of Eric Grubman. After graduating from the U.S. Naval Academy, serving four years, and attending Harvard Business School, he went to work for Goldman Sachs's mergers-and-acquisitions department. In 1994, he helped paper mogul Robert Kraft buy the New England Patriots for $175 million, then the largest team purchase price in league history. "I'd never worked on a sports deal before," he says.

In subsequent years, Grubman was called upon to work on several other NFL transactions, including the $535 million deal that brought the Browns back to Cleveland in 1998. Two years later, he handled Woody Johnson's $635 million acquisition of the New York Jets. A gift from Johnson—a Jets jersey bearing the number 635—now hangs in Grubman's office, alongside other football and Navy memorabilia.

In 2004, after having left Goldman, the NFL offered him the executive vice-president position. Since then the league has continued on its growth path. Between 2006 and 2009, team values rose 16.2 percent and player salaries rose 9.4 percent. In a pair of transactions in 2008 and 2009, real estate developer Stephen Ross paid about $1 billion to acquire 95 percent of the Miami Dolphins. In 2010 the league—which Grubman calls a "magical, resilient business"—brought in $8 billion in revenue.

Right now the league remains committed, as Grubman says, to growing that $8 billion pie. Even in the nearly saturated domestic market, the NFL is trying to reach outside the male demographic with a clothing campaign targeting women. The biggest opportunities, however, may be outside the U.S. The NFL has been staging exhibition games abroad since 1976—the year the Cardinals beat the Chargers in Tokyo—and, like any glob-

FROM LEFT: BILL AMATUCCI, JR./DIAMOND IMAGES/GETTY IMAGES; MICHAEL N. TODARO/GETTY IMAGES; MARTHA CAMARILLO; JERRITT CLARK/GETTY IMAGES; DOUG BENC/GETTY IMAGES

1981: A 50-day strike cancels 712 MLB games as players and owners fight over free agent compensation

1982: NFL players strike for 57 days over the league's revenue structure. Players eventually get $1.28 billion added to their salaries and benefits over five years

1983

1984

1985: Baseball players strike for two days and get minimum salaries raised from $40,000 to $60,000

1986

1987: NFL players strike, but efforts fail when some cross the picket line. The strike later inspires the forgettable Keanu Reeves film, *The Replacements*

1988

1989

1990

1991

1992: First official strike by the National Hockey League Players' Assn. yields increased playoff bonuses and an extended season

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The Players

The NFL and NFL Players Assn.'s top contributors, along with their respective stats

Roger Goodell



Position: **NFL Commissioner**

Age: **51**

Education: **Washington & Jefferson College**

Experience: **Joined the NFL as intern in 1982. Held the role of chief operating officer before being named to succeed Paul Tagliabue in 2006**

Compensation: **$9.76 million (2009)**

Eric Grubman



Position: **NFL Executive V.P. of Business Operations**

Age: **52**

Education: **U.S. Naval Academy, Harvard Business School**

Experience: **Former partner and managing director at Goldman Sachs, former co-president of Constellation Energy Group**

Compensation: **$4.44 million (2009)**

DeMaurice Smith



Position: **Executive Director, NFL Players Assn.**

Age: **46**

Education: **Cedarville University, University of Virginia School of Law**

Experience: **Partner at Patton Boggs law firm, counsel to then-Deputy Attorney General Eric Holder at the U.S. Justice Dept.**

Compensation: **$1.8 million**

Kevin Mawae



Position: **President, NFL Players Assn.**

Age: **40**

Education: **Louisiana State University**

Experience: **Played 16 seasons with the Titans, Jets, and Seahawks; elected president of the NFLPA in 2008**

Compensation: **No salary**

ally minded business entity, has its eyes on China. Two million Chinese citizens already identify themselves as NFL fans, Grubman says. Buffalo Bills offensive lineman Ed Wang, the first NFL player of full Chinese descent, was among the White House guests during Chinese President Hu Jintao's recent state visit. "Teams and team values and team profits—according to every other indicator—continue to increase over the decades that owners own teams," says the NFLPA's Smith. "I think that's good. But that's juxtaposed against a player who plays for 3.5 years."

By objecting to the owners' proposed terms, the players say, they're not inhibiting league growth but looking out for the health and security of future colleagues. Atallah points out that the players don't really receive the nearly 60 percent of revenues stipulated in the current agreement; they get closer to 50 percent. The owners, he says, currently take about $1 billion off the top each year for overhead costs, including financing stadiums and the NFL Network. "What other company taps its workers to pay for overhead?" Atallah asks.

Meanwhile the business of football is proceeding as usual. The NFL's college draft, which is the next signature event after the Super Bowl, will occur on schedule. The fear of a lockout hasn't had much effect on the college ranks. So far, 56 players have renounced their remaining college eligibility to enter the draft, more than in any previous year. Without a new labor agreement in place, however, teams won't be able to sign these players. And with no official training camps, all players would be left to stay in shape—both physical and financial—on their own.

Some are already venting their frustration. On the day after his team lost to the Pittsburgh Steelers in the AFC Championship Game, Jets cornerback Antonio Cromartie lashed out at both sides. Standing by his empty locker, Cromartie, a father of nine who earned $1.7 million this season, said: "They need to get their s--- together and get it done." The five-year veteran has reason to complain. As a free agent, a lockout would prevent him from signing a new contract. "You don't get no information about nothing from the union or the owners," he continued. "To tell you the truth, they need to get their damn minds together and get this s--- done."

Grubman won't discuss his talks with the union or hint at how close a new deal might be. This is his first major test at the NFL, and if he passes it, he could one day end up succeeding Goodell. Since he still cites his naval experience as the touchstone of his career, it's worth recalling his role in another standoff, serving on a fast-attack submarine in the waning days of the Cold War. That confrontation ended not with the stroke of a pen or the firing of a missile but when one side crumbled from within. Ⓑ

NHL players are locked out for 104 days as the two sides haggle over a salary cap

Baseball players strike for 232 days, canceling nearly 1,000 games and an entire post season—a first in professional sports

NBA players refuse a hard salary cap, leading to a shortened 50-game season

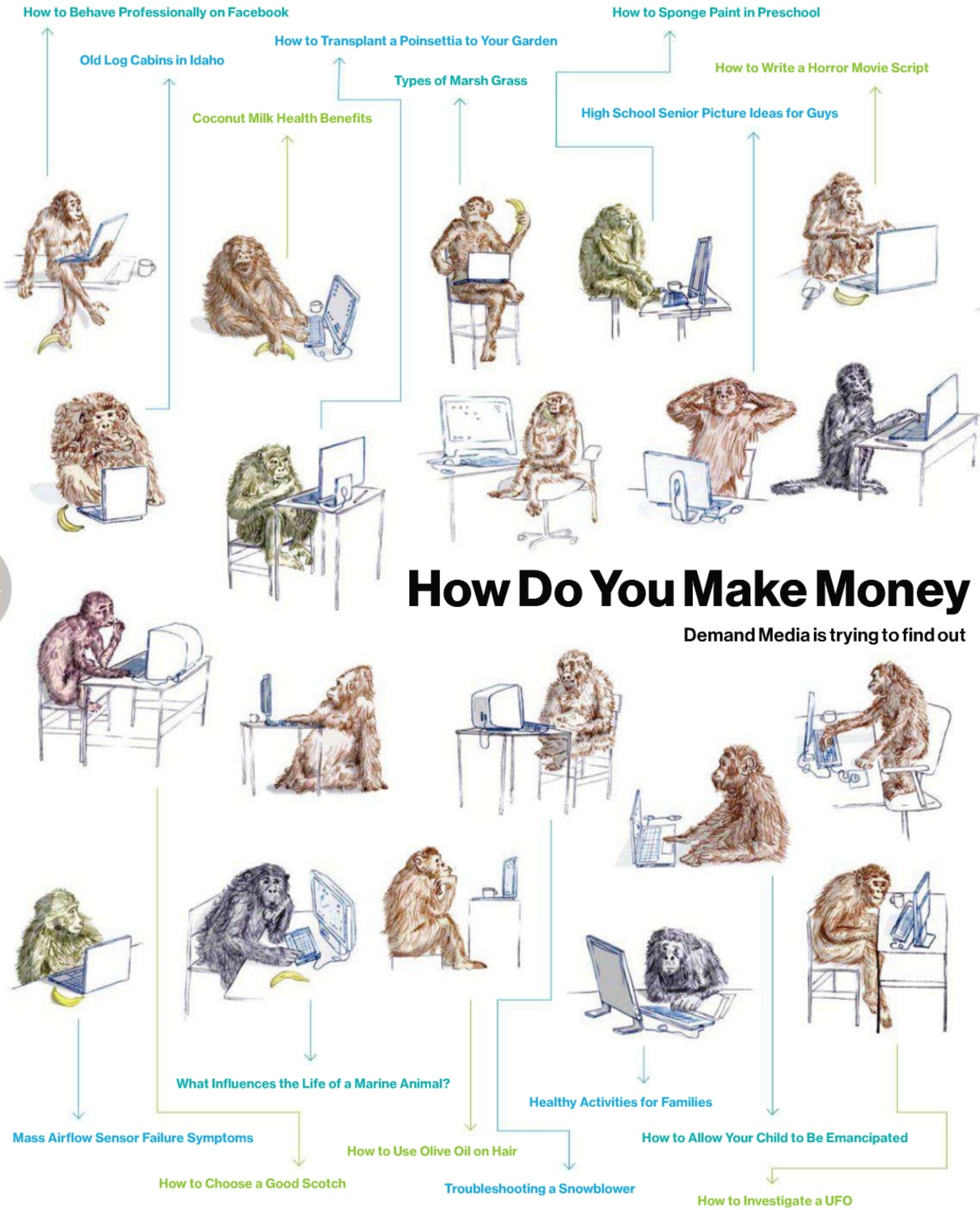
Disagreement over proposed salary cap leads to the cancellation of the entire NHL season

1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005

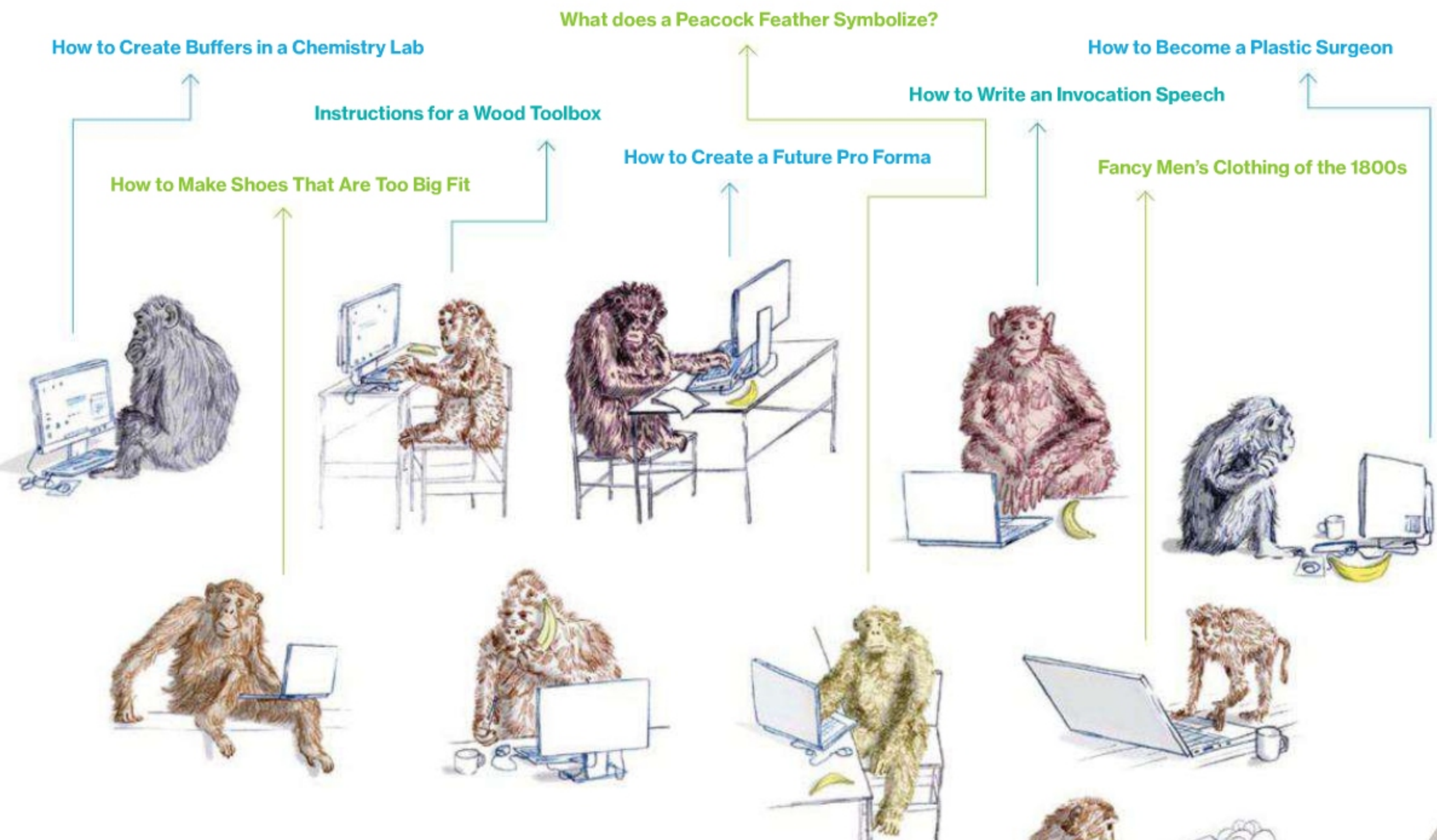
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How Do You Make Money

Demand Media is trying to find out

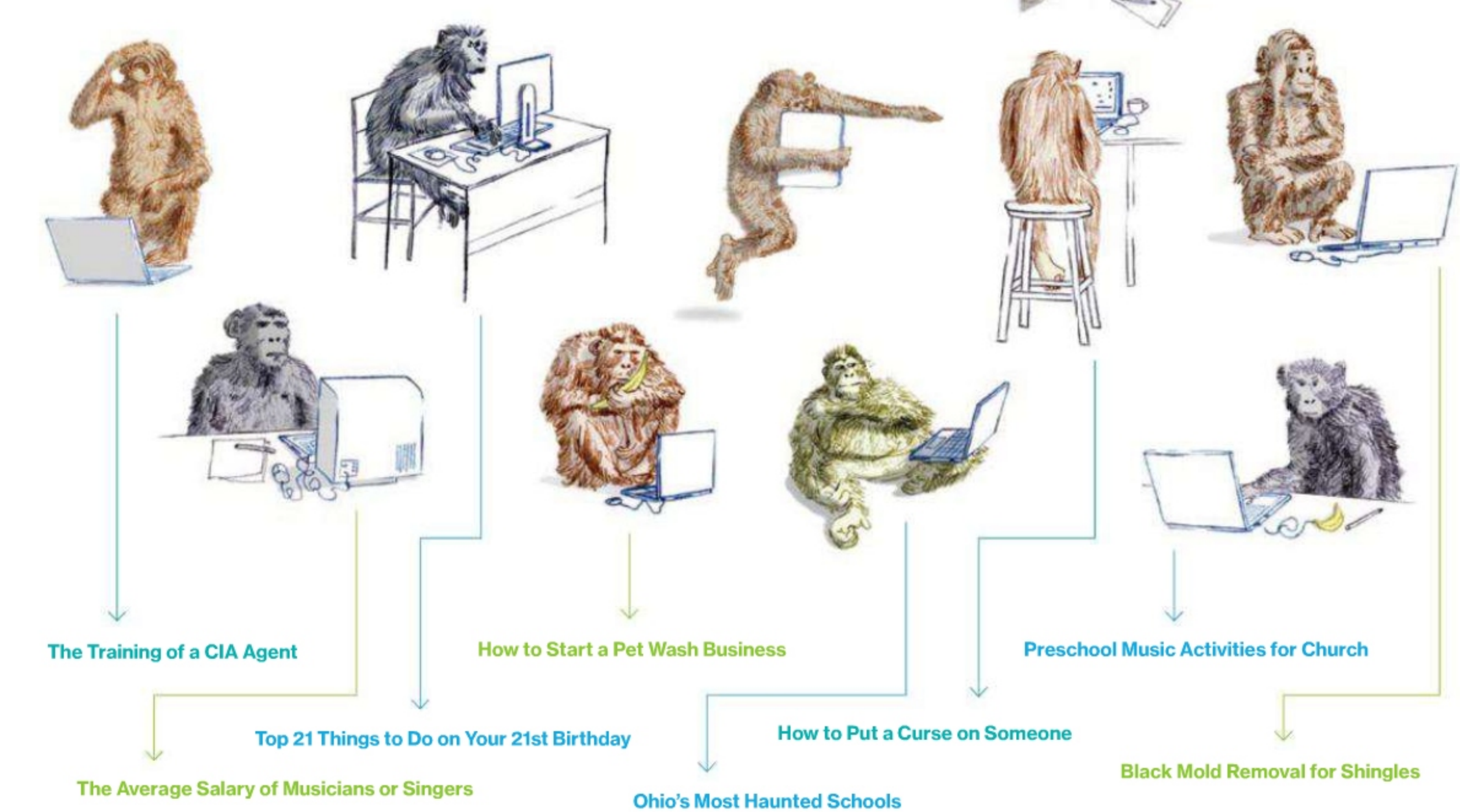


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Answering Questions?

By Felix Gillette Illustrations by Leif Parsons



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"We are thinking through the implications of, 'How do you editorially program the planet?'" says Byron Reese.

It's March 2010, and Reese, the chief innovation officer of Demand Media, is accepting a "game changer" award for innovation at the We Media conference in Miami. Several dozen people listen as he invokes Demand's plan for cranking out Web pages and videos to quench every last bit of human curiosity wherever it springs up. The plan's code name: Little Brother, a nod to George Orwell.

Reese does not share many details about how Little Brother will work. Instead, he shows an image from *The Terminator*. "Perhaps at this point you're thinking, 'I know where all this is going,'" says Reese. "'I've seen this movie before. The machines are going to start making the decisions. We're going to be ignorant. They're going to take over.'" He assures his audience that Demand Media will not annihilate humanity.

Over the past decade, Reese has quietly pioneered a new breed of media company, colloquially called a "content mill." Where traditional media companies rely on creative professionals to generate ideas aimed at loyal repeat readers, content mills are far more transient. They rely on crowd-sourced stories and search engine optimization, the art of gaming online search results to ensure one appears at the top, to rope in drive-by users looking for a quick hit of information—how to hang a door, say, or make sourdough starter. The pedigree of the source providing it is not important.



How to Dress Like an *Anime* Schoolgirl

Large media companies, including Yahoo! and AOL, are introducing variations on the content mill model, hoping to draw more traffic, and in turn more advertising revenue, while lowering the costs of content creation. Demand Media is the fastest-spinning mill of all, currently producing more than 5,000 articles and videos for the Internet every day on topics often selected by computers. A decentralized horde of 13,000 freelance writers, editors, and producers earn minimal fees (around $15 for writing an article of a few hundred words) to keep the production line humming. The resulting stories are distributed across Demand-owned websites such as eHow.com, Answerbag.com, or Livestrong.com and are hyper-engineered by specialists to appear at the top of search engine results for a vast number of queries. The stories, which are not tied to news events and are thus designed to have long shelf lives, tend to be coherent but uninspired. The potential for monetization is said to be vast.

"It's a great business model," says Ken Doctor, an affiliate analyst for Outsell. "They've been pioneers in defining a new content creation model based on harnessing so much low-cost content and matching it better than anyone with targeted advertising."

"They really understand consumer behavior on the Web and how to build businesses on it," adds Sheryl Sandberg, Facebook's chief operating officer.

"I feel privileged to be an investor," writes Aviv Nevo, head of venture capital firm NV Investments and one of the largest holders of Time Warner stock, in an e-mail. "I am confident that the company will continue to be the premier leader in the creation of rich, focused and tailored content."

On Jan. 25, Demand Media sold 8.9 million shares at $17 each in an initial public offering. The following day, the price rose 35 percent to $22.61, which would give the company a market capitalization of $1.9 billion, greater than New York Times Co.'s value of $1.5 billion.

The company spent the past few months in a pre-IPO quiet period. As a result, Reese and Chairman and Chief Executive Officer Richard Rosenblatt, the company's press-friendly face, were unable to comment at press time. According to the prospectus, Demand plans on using the influx of capital for product development and international expansion. Executives have said in the past that someday Demand hopes to crank out as many as a million articles and videos every month.

A disproportionate chunk of Demand's revenue comes from Google, making the search giant a life raft

At the Miami conference, as Reese finishes up his *Terminator* presentation, he makes it clear that, while easily parodied, he doesn't view himself or Demand as a bringer of intellectual destruction. "This is a frightening notion of the future—that somehow in doing this we lose our fundamental humanity," he says. "I don't think this is the case."

One of Demand's primary selling points to investors is that in just a few years of existence it has already built a huge Web audience. Its prospectus promotes the fact that its sites attracted 105 million unique visitors in November 2010, according to comScore data, making it the 17th-largest Web property in the U.S.

Raw traffic numbers tell only part of the story. Many analysts now say the best way to gauge a Web company's financial hardiness is to look not at page views or monthly unique visitors but at how much money it can generate from each user. Matthew Shanahan, senior vice-president of strategy for Web consulting firm Scout Analytics, says thriving digital ventures typically have a high ARPU (average revenue per user). Amazon.com, for instance, makes on average $189 per unique user. Google takes in around $24. Web publishers, Shanahan says, tend to become reliably profitable at about $10 a user. Demand's average revenue per user currently hovers around $1.60.

Since launching in 2006, Demand has yet to turn a profit. In 2009 it lost $22.4 million on $198.4 million of total revenue, according to its prospectus. In the first nine months of 2010, it lost $6.3 million on revenues of $179.3 million. While it has a lot of unique visitors, they tend to have minimal exposure to advertising, because the average user bounces into a Demand site—and bounces out just as quickly.

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Properties of Kitty Litter



According to data from Web research firm Alexa, the average visitor to eHow, Demand Media's most visited site, spends only 2.3 minutes and clicks on 1.7 pages before departing. By comparison, Facebook users average 31.9 minutes and 12.7 page views per visit.

"There is no brand loyalty there," says Shanahan. "They are relying almost purely on bringing in new customers using search engine optimization, which attracts a fly-by audience. As a result, you have this huge revenue risk: Can they keep winning new people? If I were a potential investor, that's the question I would be asking."

In the years ahead, a number of factors could make it tougher for Demand to keep expanding its audience of unique visitors. Considering its voluminous output, Demand eventually could run low on new, lucrative, and underserved how-to subjects. The rise of social media could negatively affect a business model that is unlikely to generate much traffic from recommendations from "friends." Or search engines could tweak their algorithms, making it harder for Demand to score high in search results across such a broad range of subjects. "Looking at the current model—can you really keep doing that for five years and grow the top line the way you're trying to grow it?" asks Shanahan. "It doesn't seem plausible."

A disproportionate chunk of Demand Media's revenue comes directly from Google—making the search giant a life raft for the company. During the first nine months of 2010, according to Demand Media's Securities and Exchange Commission filings, 28 percent of total revenues came from Google. Demand is aware of the risk of piggybacking so heavily on one source for traffic and revenue, warning potential investors in its SEC filings that the company is "dependent upon certain material agreements with Google for a significant portion of our revenue" and that a "termination of these agreements, or a failure to renew them on favorable terms, would adversely affect our business."

"For Google to make a change that would wipe out Demand Media, I'd be surprised," says John Andrews, an SEO consultant in Seattle. "They are carrying Google's ad inventory." Yet on Jan. 21, Matt Cutts, the engineer overseeing Google's search quality team, posted on the company's official blog, explaining that as pure Web spam decreased, the company had shifted its focus and made two major "algorithmic changes" over the past year targeting mills. "Nonetheless," wrote Cutts, "we hear the feedback from the Web loud and clear: People are asking for even stronger action on content farms and sites that consist primarily of spammy or low-quality content." Does Google consider Demand a content farm? The company did not respond to several e-mails seeking comment.

Gabriel Weinberg, the founder of DuckDuckGo, a niche, privacy-oriented search engine, says the blog post looked to him more like a "PR offensive" than an actual change in policy that would affect Demand. Last year, Weinberg says, after receiving numerous complaints about the quality of Demand articles, he tweaked his algorithm to strip Demand content from his search engine's results. He doubts Google will follow his lead. "They'd be editorializing," Weinberg says. "I think they would be accused of censorship."

Over the past year, Demand executives have taken steps to diversify the company's revenue stream. They have struck a handful of partnerships selling Demand content wholesale to third parties, including the websites of *USA Today*, the *San Francisco Chronicle*, and the National Football League. And in March 2010, Demand hired away Yahoo's Joanne Bradford, an experienced digital ad sales executive, to become Demand's chief revenue officer. Bradford now oversees an ad sales staff charged with bringing in brand advertising independent of Google.

In the meantime, the competition among media companies to engineer their content onto the all-important first page of Google search results, no matter how obscure the query, is intensifying. Outsell's Ken Doctor says that businesses such as Examiner.com and Yahoo! Contributor Network are elbowing in on Demand's territory. "Other companies are



Las Vegas Tenant Eviction Procedures



Reese aspires to fill every gap in humanity's collective knowledge with online content

organizing their own stringer freelance networks using the same kind of technology," says Doctor.

As a result, Demand Media will have to devise new and better ways of extracting revenue from each of its customers in the months to come. For that they are likely to lean heavily on the man who swears he's not the Terminator.

Reese, 42, was born and raised in Texas and graduated from Rice University in Houston in 1991 with a degree in economics. According to his official bio on the Demand Media site, he ran his first business in college, orchestrating "elaborate practical jokes." Reese was unavailable to speak with *Bloomberg Businessweek* for this story, but interviews with a handful of former colleagues, who say they spent rewarding stretches of their careers working intimately with him, yielded a strong impression. Over the past decade few entrepreneurs have dreamed up more effective and improbable methods of squeezing profits out of obscure corners of the Internet.

Reese lives in a restored Victorian house in the small town of Georgetown, about 25 miles north of Austin. He and his wife, both devout Christians, homeschool their four children and have decorated their home with Biblical paintings. He is an avid deer hunter, has a thing for Byzantine history, and not long ago visited North Korea. According to former colleagues, he has an endless number of business ideas.

"He's an idea generator," says David Hehman, an angel investor in the San Francisco area who helped to back Reese's first major Web venture. "The guy just has a gazillion ideas," says Johnny Anderson, a business executive in Texas who worked alongside Reese at a software company called HotData in the late '90s. "He comes up with off-the-wall ideas and then he executes them," says Zach Hotchkiss, Reese's former head of e-commerce and marketing.

One of Reese's longtime passions,

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according to his former colleagues, has been making money by identifying and filling in what he sees as the vast gaps in humanity's collective knowledge, as represented by pages on the Web. Over the past decade, Reese has made a small fortune running an eclectic series of Internet ventures somehow related to this idea—and that collectively set the framework for much of Demand Media's current business model.

Around 2000, after roughly a decade working as a marketing executive for various software companies in California, Oregon, and Texas, Reese decided to strike out on his own and wrote a business plan for a company called Brilliant Pebbles, borrowing the name of a Reagan-era missile defense system. At the time a number of media giants—AOL, Yahoo, Microsoft, and others—were battling to create the dominant portal. Reese saw an opportunity: What if there were no portal? What if search engines, particularly Google, became so efficient and well-trafficked that users bypassed gatekeepers and went right to the content?

Reese's idea, according to Anderson, was to create a media company catering directly to Google users. The articles could be largely unbranded, because people wouldn't be coming to you for your news judgment, editorial style, or the number of Pulitzers your staff had won. They'd be coming to your page to learn, say, how to treat an allergic reaction to a bee sting because they stumbled on it immediately after they got a bee sting and turned to Google for answers.

In 2000, Hehman decided to help back Brilliant Pebbles. "I liked Byron's raw intelligence," he says. "This guy is probably the smartest guy I know, and it's on a variety of topics: everything from the world's religions to history to technology. He's a really eccentric individual."

Reese opened an office in Austin and

Every week, Reese would come up with something new to peddle. The crew would draft a business plan and launch a website



renamed the company PageWise. To make the venture work he needed lots of low-cost content, so he launched a feeder site called writeforcash.com. "From needlecrafts to networking, we need your articles," read a version of the site's home page. "We are seeking articles on specific topics that we know to be popular and sought after by people searching on the Internet. Some examples include, 'How to program a universal remote,' 'How to make a sock monkey,' and 'All about Louis Vuitton Handbags.' Get started today!"

Potential candidates flooded in, and Reese gathered a collection of writers willing to fulfill assignments for minimal fees (typically $10 or $15 per article) and no benefits. He used the incoming articles to stock a hodgepodge of sites, such as AllSands.com and WebGuru.com, which promised "to mine all the knowledge of the human race and make it available for free to everyone."

Reese's plan was to monetize the resulting Web traffic using advertising. Then the Internet bubble burst and ad rates plummeted. "We laid everybody off," recalls Hehman. "It was just Byron, his ideas, and the chief technology officer."

Reese reconsidered his business model. Thanks to the churning content mill, he had lots of article pages and plenty of eyeballs, but no significant advertising. So, in a period of aggressive experimentation, he decided to try to monetize his own audience with his own advertisements for his own products.

Every week, according to Peter Handsman, the former CTO, Reese would come up with an idea for something new to peddle. They would draft a business plan, launch a website, and measure consumers' subsequent interest in a product. Efforts to sell coins and watches failed. At one point, Reese tried manufacturing family portraiture using inexpensive subcontractor artists in places such as Russia. The concept wasn't easy to expand. "A lot of people have ideas," says Handsman. "Byron has the discipline to actually measure them. He was willing to come up with a ridiculous number of ideas, but he was also willing to abandon them if they were proven not to work."

Eventually some experiments succeeded. One early hit was a genealogy website where customers could create collectible items decorated with customizable family crests. Reese bought a laser engraver and began shipping out everything from scrolls to plaques to wine glasses decorated with ornate insignias. At around the same time, PageWise happened onto a surprisingly lucrative market for customizable Italian charm bracelets.

In 2002, PageWise launched santamail.org. The site sold parents personalized letters from Santa Claus for their kids. Each letter was postmarked North Pole, Alaska, and sold for $9.95. "The margins were ridiculously high," recalls Hotchkiss, the former head of e-marketing for PageWise. "The volume was insane. It became a cash machine."

Shortly thereafter, Reese's content mill prototype started producing serious revenue, too, thanks to Google's AdSense. Under the program, which launched in 2003, Web publishers could sign up to be Google partners. Google would then go out and sell ads, place them alongside related content on partners' websites, and share a cut of the resulting revenues. "We were selling $6 million worth of jewelry a year by then," says Hehman. "The content money was just gravy."

Reese kept tinkering. In the summer of 2005 he launched happynews.com, which aggregated sunny news stories from around the Web. The site was popular with readers and a punching bag for critics. "Prozac for the eyes," wrote Paul Farhi in *The Washington Post*.

Reese had ambitions beyond text. He told colleagues that as the price of bandwidth fell, people would begin spending more time viewing Web videos. According to his calculations, Hollywood was spending an average of about $1,000 per one-thirtieth of a second of video. He set out to see if he could produce video for a penny a frame. Not long after jumping into the happy-news business, Reese launched a how-to video site called ExpertVillage.com. In August 2006, the company announced the official debut of its Filmmaker Program. The idea was to recruit some 5,000 freelance filmmakers. Once registered, they could claim assignments from a long list of search-friendly

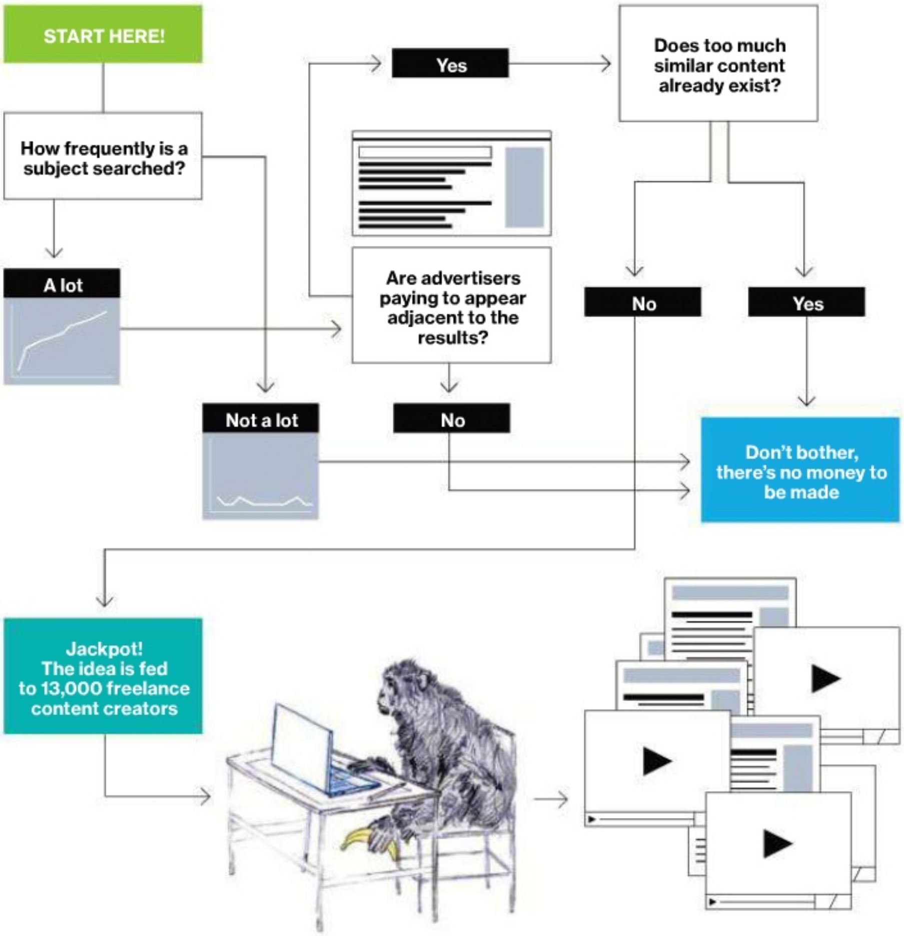


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How to Develop the Third Eye Chakra

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The Answer Farm

How Demand Media uses algorithms to determine whether creating content around a particular search topic will be profitable



topics. Reese budgeted $2 million to create 75,000 how-to videos over the next 18 months. "We looked at the production of video not as a creative process as it has always been viewed but as a manufacturing process," Reese said in a radio interview with the Christian news organization American Vision. "When it's a manufacturing process, you learn how to optimize certain steps of it and lower costs."

In 2006, Richard Rosenblatt, a polished Southern California media executive, founded Demand Media with an investor named Shawn Colo. Rosenblatt had previously run Intermix, the parent company of Myspace, and orchestrated a sale of the company to News Corp. for $580 million. Rosenblatt and Colo raised $355 million and went on an acquisition spree, eventually purchasing eNom, now the world's second-largest Internet domain registry; eHow.com, an online instructional content provider; Pluck, a social networking business; and a hodgepodge of niche content sites, such as Cracked.com and GolfLink.com.

What attracted Rosenblatt to PageWise, according to former CTO Handsman, was not the Italian charm bracelets, the family emblem scrolls, the letters from Santa, or even the happy-news stories. Rosenblatt was interested in Reese's model for manufacturing high-volume, low-cost videos. In June 2007, Demand Media bought PageWise for $15.8 million.

To make cheap content, Demand relies on its seemingly ever-expanding army of 13,000 freelance writers, copy editors, and filmmakers, who have passed the company's vetting process to become members of something called Demand Media Studios. Once accepted into the "studio," writers and producers can log onto a website and choose assignments from a list of possible topics.

The assignments are generated via proprietary black-box technology, which sifts through data on what people are typing into search engines, compares the search queries with keyword advertising rates, and then analyzes how many websites are already serving that particular market. If after mining the data the algorithm determines that a certain headline for a specific topic, no matter how obscure, will be profitable, it pushes the idea into the pipeline. Last year, Demand Media executives told *Wired* magazine that the mechanized assignments generate 4.9 times more revenue than ideas generated by humans.

In the spring of 2007, a few months before selling PageWise to Rosenblatt, Reese delivered a lecture at Austin's annual South by Southwest festival. His topic: how to start an Internet business for $100.

That afternoon, Reese recommended the crowd get into Web publishing. "The Internet has six billion pages on it right now," Reese said. "Believe it or not, it needs a whole lot more. There's a huge, huge, huge shortage on the Internet of the kind of information that people are actually searching for." The key, he said, was to keep costs low. If possible, don't pay for the intellectual content. Look for material, he urged, on which the copyright has expired. Any book published in the U.S. before 1923 was available.

He said he was in the process of turning vanloads of old books into websites. With a few hours of labor, for example, you could take a turn-of-the-century Creole cookbook and transform it into the definitive site for vintage Creole recipes. Google's AdSense program would then load the thing up with ads for shrimp and cooking pots and spices and direct people looking for shrimp recipes to your website. Every time someone clicked on an ad, you got a cut of the resulting revenue. On a click-by-click basis, those payouts were likely to be minuscule. Don't scan one book. Scan a thousand.

Reese said that years earlier he had created a site called Essortment.com. Over the years the cheaply constructed nonperishable articles stayed more or less the same, while fresh Google ads kept pouring in. "To this day, Google sends me over a hundred thousand dollars a month off this one site," said Reese. "It's like the Energizer Bunny. It goes up to $200,000. It drops off to $70,000. But it never fluctuates out of that range. Year after year after year."

Demand Media executives hope the same is true for their growing library of videos and articles—an ageless future, supported in perpetuity by Google paychecks. They are not the Terminator. They are a pink, fuzzy, hardworking bunny.

As he wound down his talk in Austin, Reese explained the key to success on the Web. He told the crowd of conventioneers to have a bias toward action and not to try to be too smart. "Be as agnostic as possible," he said. "Don't be a true believer in anything." B

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Etc.

Who should play Dick Fuld in a financial-crisis blockbuster?
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Dude, There's My Car!

Auto buffs trek to Scottsdale for the year's largest car auction, where bling, babes, and big blocks reign supreme. *By Paul M. Barrett*

Photograph by Misha Gravenor

TOP: ANDREW HARRER/BLOOMBERG

Etc. Cars

After getting his teeth cleaned one evening in 1976, Elvis Presley told his dentist he had a surprise. The King took Lester Hofman, D.D.S., to the parking lot, pointed to a silver Cadillac Seville with a burgundy vinyl roof and announced that the car was a gift—a token of appreciation for maintaining the trademark Elvis smile. On Jan. 22 the Presley Cadillac—complete with papers in Elvis' name—changed hands again, this time for $35,200, as one of the highlights of the largest and gaudiest annual car auction in the U.S.

According to Jay Leno, the average attendee is a "John Deere tractor distributor with the gold chain"

Every January, thousands of collectors gather in Scottsdale, Ariz., for the Barrett-Jackson auction, the main stop on the winter auto circuit. The family-run affair melds the gasoline-fume intoxication of the Daytona 500 with the daffy hedonism of a Las Vegas floor show, decorated with a sprinkling of nouveau riche glitter. As Barrett-Jackson Chief Executive Officer Craig Jackson said, reclining in his customized RV, "This is capitalism at its best."

The Arizona crowd is far removed from the popped-collar elite who gather in August for the more refined Pebble Beach Concours d'Elegance on California's Monterey Peninsula. Compulsive car collector Jay Leno once noted that the typical Pebble Beach customer is clad in Ralph Lauren, while the Barrett-Jackson attendee is a "John Deere tractor distributor with the gold chain and the 28-year-old wife with the big boobs." Or, put another way: "We're an aspiration-lifestyle destination event for a much wider audience, especially people getting started in collecting, or who just want to come look at the cool cars," said Steve Davis, Barrett-Jackson's president, who wears wraparound sunglasses indoors and fist-bumps at every opportunity.

Regardless, the cars sell. This year the six-day sale moved more than 1,200 autos, boats, and tractors for a total of $70 million, up 3 percent from 2010. Among them was the 1963 Pontiac Bonneville ambulance that purportedly transported John F. Kennedy's casket from Air Force One to the Bethesda Naval Hospital, and later to the U.S. Capitol. The battleship-gray ambulance sold for a cool $132,000. (The vehicle's provenance is in dispute, but Barrett-Jackson claims to have paperwork and other evidence showing it's legit.) Of less historical significance—but still the focus of intense collector fascination—was Sylvester Stallone's black 1956 Ford F-100 pickup, which commanded an identical $132,000. It may be the only star of *The Expendables* that came out looking good.

Although privately brokered deals account for the vast majority of transactions—including many of the most expensive—public auctions like Barrett-Jackson are the most visible barometers of the collectible car industry's health. Barrett-Jackson (no relation to this reporter) takes in about $150 million a year in corporate revenue, according to Vice-President Gary Bennett, a former architect from Tulsa whose long graying hair tumbles down his back. The company sells sponsorships to carmakers such as Ford Motor and General Motors, licenses its brand for clothing (short-sleeve shirt: $50), and charges admission ($15 to $55 at the door) to its events.

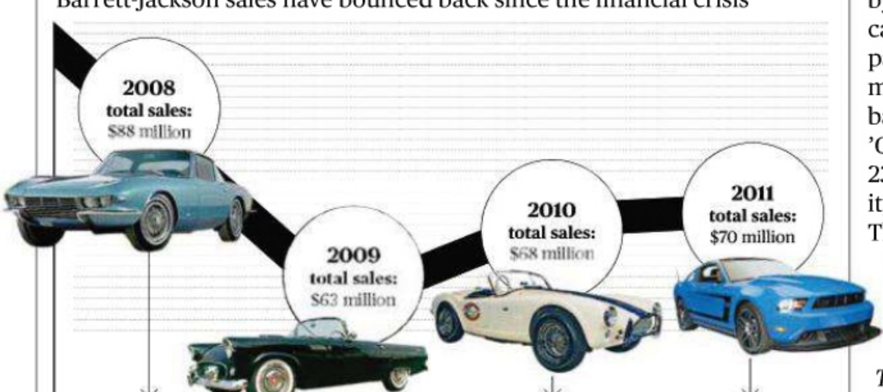
Barrett-Jackson, which is privately held, runs three auctions in addition to Scottsdale: Palm Beach, Fla., in April; Orange County, Calif., in June; and Las Vegas in September. The January event, however, remains the company's flagship. "If you love anything with an engine, as I do, this is the place in January," said Bennett's wife, Muffy.

The tradition dates back 40 years to the Fiesta de los Autos Elegantes, a modest auction co-founded by Craig Jackson's late father, Russ. The current incarnation sprawls across a nearly 200-acre expanse packed with barbecue stands, neon-decorated auto memorabilia, and oil paintings of long-legged fantasy babes bending over the hoods of Mustangs and Hemi 'Cudas. Virtually everything is for sale. More than 230,000 people attended this year, the vast majority as paying spectators, not bidders or consignors. The opening-night gala offered stiff cocktails, gourmet sushi, and a classical ensemble playing a thunderous version of Led Zeppelin's *Kashmir*.

Connoisseurs of the classics could find a 1938 blue Buick Brewster Town Car straight out of *Dick Tracy* ($60,500), a winsome 1941 GMC Suburban Woody Wagon ($110,000), and a dark-green 1952 Rolls-Royce Silver Dawn Mercia Special ($99,000). Barrett-Jackson's specialty, though, is 1960s Detroit muscle: noisily powerful, big-block Camaros, Corvettes, and Chevelles. Many bidders were looking for modest coups. Jonathan Liebelt, 40, walked away from his

Growth Engines

Barrett-Jackson sales have bounced back since the financial crisis



Biggest sale: *1963 Chevrolet Corvette coupe "Rondine" concept car*: $1,760,000

Biggest sale: *1955 Ford Thunderbird convertible "Production #1"*: $660,000

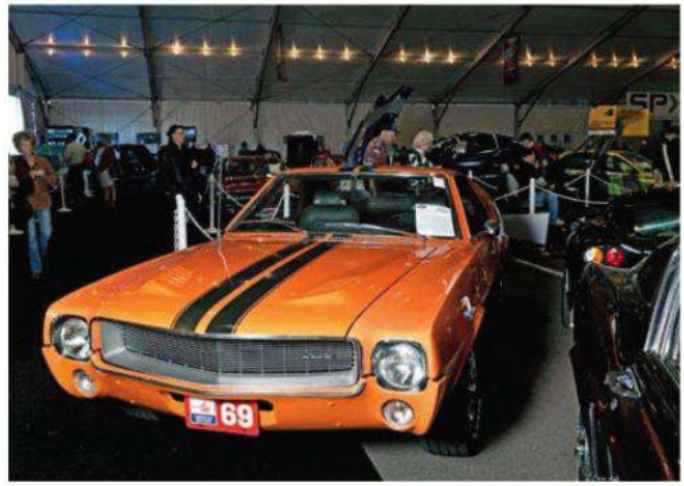
Biggest sale: *1964 Shelby Cobra Roadster*: $478,500

Biggest sale: *2012 Ford Mustang Boss 302 Laguna Seca*: $450,000

DATA: BARRETT-JACKSON

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A Barrett-Jackson autioneer's aide eggs on bidders (left). A 1969 AMX draws admirers (upper right), as does a 1976 Cadillac, a gift from the King

PHOTOGRAPHS BY MISHA GRAVENOR FOR BLOOMBERG BUSINESSWEEK

ninth Barrett-Jackson auction with a screaming-orange 1969 American Motors AMX Coupe, believing the vehicle was "seriously undervalued" at $29,150. (Buyers pay Barrett-Jackson a 10 percent commission on top of the bid price; sellers pay 8 percent.) Liebelt said he looked forward to showing off his AMX back home in Aberdeen, S.D., and then eventually reselling it for a profit. "If you get a good price to start, these cars only appreciate in value," he said as well-wishers slapped him on the back.

The auction resembled an old-style Chicago commodities-trading pit. One group of bidders huddled on the auction block, studying the cars as burly handlers wearing black gloves rolled the vehicles by. Other potential buyers were scattered around the audience. Bidders indicated interest with gestures to runners. The runners used guttural exclamations and elaborate hand signals to convey dollar amounts to relay men, who sent word to the chief auctioneer, Spanky Assiter. When he was unimpressed with what was being offered, Assiter goaded the crowd: "Testing, testing, can you hear me?" he asked, tapping the microphone.

"This is capitalism at its best," exclaims CEO Craig Jackson, reclining in his customized RV

Wayne Halabura, a 56-year-old homebuilder from Saskatoon, Sask., designs one-of-a-kind hot rods as a hobby. He brought his latest work to Scottsdale: an award-winning handmade reproduction of a 1932 Ford roadster crafted over a period of 10 years. "I'm not emotional about selling it," he said about the steel-body, roofless beauty. "I do this for the challenge." The two-seater with an all-aluminum stroker engine sold for $346,500.

Others in the arena admitted to more ambivalence. Steve Cole of Brentwood, Tenn., restores autos for Alan Jackson, the country music star, whose 1993 hit, *Chattahoochee*, recalls the fogging up of a certain old Chevy. The singer sold four cars from his personal collection this year. One, a 1965 German-made Amphicar 770, has white-wall tires for driving on land and boat propellers for traveling on water. The two-door curiosity can do 70 miles per hour or seven knots. After spirited bidding, the amphibious convertible, with its aqua paint job and apricot upholstery, sold for $123,200. "I love restoring cars for Alan Jackson," said Cole. "But he is breaking my heart selling this one." ❸

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Casting The Crash

If the 2008 economic meltdown were a movie...

It was only a matter of time. In the wake of last year's financial crisis morality tale, *Wall Street: Money Never Sleeps,* and the Matt Damon-narrated documentary, *Inside Job,* comes a veritable bubble of subprime films. *The Flaw,* a documentary that examines the roots of the mortgage mess, and *Margin Call,* starring Kevin Spacey as the head of a foundering investment bank, both debuted at the Sundance Film Festival in January. HBO's adaptation of Andrew Ross Sorkin's book *Too Big to Fail* is in the works, with Paul Giamatti as Federal Reserve Chairman Ben Bernanke. Brad Pitt's Plan B Entertainment production company also has optioned Michael Lewis's latest mega-best-seller, *The Big Short.*

This new genre might be perfectly suited for the big screen. "The financial crisis itself is intensely dramatic," says *The Flaw* director David Sington. "You have interesting characters–people with different degrees of knowledge, different views about what's happening. And it plays out in a very short time."

In the spirit of beating Tinsel Town to the box office, *Bloomberg Businessweek* picked its ideal financial crisis movie cast by asking top Hollywood casting directors who should play the bankers, politicians, and economic gurus who dominated headlines during the implosion that was. Unlike in the real world, though, our hypothetical budget is unlimited. And, this being Hollywood, our story includes a role for Sarah Palin. This is show business, after all. —*Rachel Wolff*

The Panel

Sarah Finn
Casting credits: *Wall Street: Money Never Sleeps, W., Iron Man, Crash*

Billy Hopkins
Casting credits: *Precious, Nixon, JFK*

Sarah Katzman
Casting credits: *Wedding Crashers, Walk the Line, 3:10 to Yuma*

Main Characters

Henry Paulson
Former U.S. Treasury Secretary

John Lithgow

Hopkins suggests that two-time Oscar nominee Lithgow play Paulson. "Of course, he'd have to shave part of his head," he notes





or...



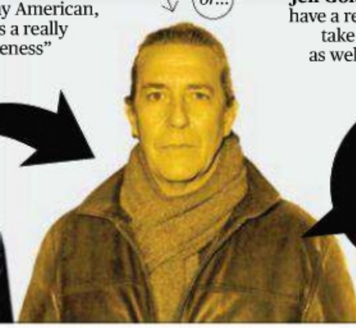
Tim Robbins, who won an Oscar for his role in *Mystic River,* is also a viable choice to play the brawny Paulson. Says Finn: "Robbins is 6'5" and has some of that energy"

Secondary Characters

Dick Fuld
Former Lehman Brothers CEO

"Dick Fuld is so specific-looking–he really has those features that people recognize," says Finn. "Ciarán Hinds was in *Munich.* He's British, but he can play American, and he has a really good likeness"





Ciarán Hinds

or...



Jurassic Park actor **Jeff Goldblum** "would have a really interesting take on the role as well," adds Finn

Tertiary Characters

Jamie Dimon
JPMorgan Chase CEO



Aaron Eckhart



Katzman: "He's just such a good actor"

Lawrence Summers
Former head of the National Economic Council



Garry Shandling



Finn: "For the physical match"

worldmags



Timothy Geithner
U.S. Treasury Secretary

"Paulson has such a physical presence," notes Finn. "He's such a big, burly guy, and I think you need to capture that"

"You usually need a mix of knowns and unknowns if you want to get the movie made," says Hopkins

Slattery is Hopkins's pick to play Geithner. "He'd be perfect," says Hopkins of the actor, whose portrayal of Roger Sterling on *Mad Men* garnered him three Emmy nominations

"All you'd need to do is dye his hair," adds Hopkins

"You try to avoid a caricature and try to get someone who is going to capture an essence," says Hopkins



John Slattery



or... "Geithner has a very specific look and quality to him," says Finn, who would consider casting **Liev Schreiber** for the role. Schreiber recently starred alongside Angelina Jolie in *Salt*



or... Finn also thinks **Patrick Wilson**—of *Angels in America* fame—could embody Geithner's "East Coast intellectual" presence

Barack Obama
U.S. President

"For Barack Obama, I say Will Smith," says Katzman. "He's youthful but not too youthful, charming, smart. He's got the whole package"



Will Smith



or... "**Don Cheadle** has that quietness, that thoughtfulness, that strength in character," says Finn of the *Hotel Rwanda* Oscar nominee

Barney Frank
(D-Mass.) Chairman, House Financial Services Committee

"I've always wanted to cast Nathan Lane in this role," says Finn. "He has the verbal dexterity, the humor, and the wit"



Nathan Lane



or... "What would be fun is if you did **Senator Fred Thompson,**" says Katzman. "He is in politics, but he also acts"

Sarah Palin
Former Alaska Governor

Tina Fey





Katzman: "How could you possibly beat Tina Fey?"

Angelo Mozilo
Former Countrywide Financial CEO

Burt Reynolds

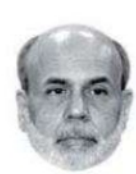




Hopkins: "Or Martin Landau"

Ben Bernanke
Federal Reserve Chairman

Stanley Tucci





Finn: "It's hard to top that"

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Today's gourmet tearooms cater to customers looking for a coffee shop experience



The Next American Tea Party

A new beverage revolution is heating up in cities all over the U.S. *By Leslie Patton*

Not since it was a British colony has America been so fixated on tea. Fifteen years ago there were a mere 200 tearooms in the U.S. Today there are nearly 3,000, according to the New York-based Tea Association of the USA. The tea shop craze arguably started in 2003 with the opening of Argo Tea's tearoom in Chicago's yuppie Lincoln Park neighborhood. "A lot of people thought it was insanity," says Chief Executive Officer Arsen Avakian, who saw a gap in the market after realizing that Americans knew only "the crappy tea bag." Avakian dreamed of creating a tea experience with cafés offering modern twists on traditional brews. "Apple completely revolutionized the computer business," he says. "We're hoping to do that with tea!"

So far it's working. Argo now has 19 stores from New York to St. Louis, and tea drinks make up 80 percent of its roughly $15 million in annual sales, Avakian says. A zero-calorie medium Argo tea costs $2.55, but a sugary signature drink that would have made the Queen Mother cringe runs about $4. These beverages have fancy names such as Earl Grey Vanilla Crème and Tea Sangria. Argo also has tried to capitalize on what Tea Association President Joseph P. Simrany calls the "allure of the exotic nature of tea" by creating a line of tea-infused foods such as chai curry chicken quinoa. It plans to have 30 shops by yearend.

The tea trend may be perfectly timed. Coffee consumption in the U.S. dipped 2.3 percent from 2006 through 2009, and tea drinking has climbed 4.5 percent, to 117 eight-ounce servings per capita in 2009, according to *Beverage Digest*. "It's been a long time coming, but it's getting bigger and bigger, like a snowball," says Michael Harney, vice-president of Harney & Sons Master Tea Blenders in Millerton, N.Y. In November, Harney & Sons opened a tasting room in Manhattan's SoHo, replete with apothecary-like cabinets and a polished walnut bar.

Starbucks has taken notice. Tazo tea has become "a billion-dollar brand" for the brewer, said Jeff Hansberry, the company's president for global consumer products, during a Dec. 1 investor call. Starbucks also recently dropped the word "coffee" from its logo. "Could that be a signal that they want Starbucks to represent more than just coffee?" wonders UBS analyst David Palmer. One thing is certain: Starbucks won't be serving caramel Teappuccinos. Argo's got the name trademarked. **B**

i

SUPERSIZE TEA

How one of Argo's tea drinks stacks up against a Starbucks calorie bomb



352 calories

Red Velvet

South African rooibos (red) tea is coupled with white chocolate and raspberry flavor.



470 calories

Starbucks' Eggnog Latte

Espresso is blended with steamed eggnog and milk and topped with a sprinkle of nutmeg.

ILLUSTRATION BY BRIAN REA

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The Late-Night Coverup

Hide your exhaustion—or your hangover at work—with Ole Henriksen's skin-care products

The Want: A way to mask fatigue, whether from working long hours, a bad night's sleep, or a cocktail flu. While you're at it, the remedy also should make you look better than usual.

The Get: Ole Henriksen's unisex peels, gels, and cremes (olehenriksen.com). To reduce dark circles and puffy eyes, apply a layer of both Truth Is in the Eyes peel ($65) and Ultimate Lift Eye Gel ($38) before bed. In the morning, rub in Fresh Start Eye Creme ($38). To glam up your complexion, try the lightweight Herbal Day Creme SPF 15 ($35). The regimen will make your skin look noticeably brighter and firmer. Fear not, penny-pinchers: The small jars last several months. —*Jessica Flint*

KITCHEN CONFIDENTIAL

Homespun remedies beyond the cucumber



Spoons

Put two teaspoons in the fridge until they are chilled, then apply one on each eye for 10 minutes. The cold spoons will help shrink dilated and discolored blood vessels.



Potatoes

Wrap grated potatoes in a cloth and place it over your eyes. You can also lay cotton balls soaked in potato juice over dark circles. Potatoes contain catecholase, a skin lightener.



Tomatoes

Blend equal parts of tomato and lemon juice and apply two times per day. Tomatoes contain lycopene, an antioxidant that protects against dark-circle-inducing ultraviolet rays.



Pineapple

Combine ¼ cup of pineapple juice and 2 teaspoons of turmeric powder into a smooth paste. Apply it to your eye area. The combination works as a bleaching agent.

BEAUTY PRODUCTS: PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK; FROM TOP: RYAN MCVAY/GETTY IMAGES; IMAGE SOURCE/CORBIS; DORLING KINDERSLEY/GETTY IMAGES; CREATIVE CROP/GETTY IMAGES

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The former PM is known in Britain as "The Big Clunking Fist," which also could describe his prose



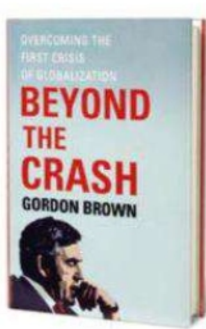
LEON NEAL/AFP/GETTY IMAGES

The Great Clunking Stylist

What lesson does Gordon Brown take from the crash? Blame America! *By Alex Massie*

Beyond the Crash: Overcoming the First Crisis of Globalization

By Gordon Brown
Free Press
336 Pages; $26



"We were days away from a complete banking collapse," writes Gordon Brown, the former Prime Minister of Great Britain and the latest financial crisis bard. Recalling the meltdown that swept the planet in 2008, he still shudders at the specter of "companies not being able to pay their creditors, workers not being able to draw their wages, and families finding that the ATM had no cash to give them." On the other hand, staving off this potential doomsday scenario may have been the perfect opportunity for Brown—the serious, number-crunching Exchequer veteran—to crawl out from Tony Blair's legacy.

It didn't work out that way. Expelled from Downing Street by an ungrateful electorate last May, Brown retreated to his native Scotland, and *Beyond the Crash* may be best seen as a therapeutic exercise in distraction. Readers seeking insight into the failure of Brown's government are given few clues. The book is stuffed with dry self-justification and more than the occasional hint of pleading. Mistakes that fostered the conditions of the crash are left largely unexamined. Finger-wagging and self-exculpation come in doses. It was the bankers' fault, he writes. And, anyway, it all started in America.

To his credit, Brown grasped the essential problems of the crisis more firmly and more quickly than many heads of state. When Fred Goodwin, then chief executive officer of the Royal Bank of Scotland, told Brown the bank merely needed overnight financing to stay afloat, the Prime Minister understood that billions of pounds of government support would be required to prevent an RBS collapse. "No liquidity without recapitalization" became Brown's mantra. Taxpayers would take an 84 percent stake in RBS as well as sizable positions in other troubled banks. The public was furious—and told there was no alternative.

Following the collapse of Lehman Brothers, Brown's government really did, as he puts it, "stand alone" in its willingness to pump immediate cash into the banking system. (The British Financial Services Authority's contribution to Lehman's difficulties is left

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unexplained.) Soon other countries followed his example, offering vast sums of taxpayer funds and open-ended guarantees to shore up and largely nationalize the tottering banks. Huge fiscal stimuli and great dollops of quantitative easing would also be needed. And while the British enjoy mocking Brown's claim to have led the world's response to the meltdown, he is entitled to some vindication, even if his solution transferred risk to national governments.

As an author, Brown remains a master of the fine-sounding platitudes he employed as a statesman. "The operation of markets must balance the necessary encouragement of risk-taking with proper standards of responsibility," he writes. How this may be achieved–and what exactly it is he's talking about–appears left for the sequel. He's equally opaque with regard to his own failed domestic policies. Most Brits outside the Labour party now appreciate that running deficits at the top of a boom left the government with precious little margin to maneuver once the good times ended. The billions pumped into Britain's sickest banks pushed the deficit above 10 percent of gross domestic product, leaving Brown's successors with few options beyond onerous spending cuts.

Yet Brown refuses to be bogged down by these unpleasant recollections. He has come to see the crisis as having been exacerbated by countries' determination to seek local solutions for international problems. The Troubled Asset Relief Program, he writes, was inefficient because it was "a plan to buy assets, not a plan for capital." Instead, he recommends a "global New Deal" to find "global solutions to global problems." Since he doesn't much explain what he's talking about, we'll just have to take his word for it. As a tireless believer in the power of summits and international confabs, Brown calls for "a constitution for the supervision of global finance." One can only presume that he will nominate himself Chief Justice of Earth's Financial Supreme Court.

A churl might note that little of Brown's account jibes with his frequent boast that his system of "light touch" regulation allowed London to become a center of financial "innovation." That was before the crash, of course, when he also bragged of having reinvented the economic cycle, putting an end to "boom and bust" once and for all. One might also note that his nickname, "The Great Clunking Fist," is an accurate appraisal of his prose style. Dry as it may be, *Beyond the Crash* offers insight into a man who, while in many ways ill-suited for modern politics, found himself at the center of a maelstrom for which he was unusually well-prepared. Brown's legacy is not a happy one, but this book suggests it could have been much, much worse. **B**

Hold the Mea!

A rundown of financial crisis tell-all authors –and their blame-fobbing ways. —*Marnie Hanel*



Author: George W. Bush	**Author:** Randall Lane	**Author:** Thomas Russo	**Author:** Henry Paulson
Former gig: President of the United States of America	**Former gig:** Editor-in-chief of *Trader Monthly* and *Dealmaker*	**Former gig:** Lehman Brothers vice-chairman and chief legal officer	**Former gig:** Treasury Secretary
Magnum Opus: *Decision Points*	**Magnum Opus:** *The Zeroes*	**Magnum Opus:** *The 2008 Financial Crisis and Its Aftermath* (co-author, Aaron J. Katzel)	**Magnum Opus:** *On the Brink*
Whipping boys: "I assumed any major credit troubles would have been flagged by the regulators or rating agencies"	**Whipping boys:** Bankers, the government, his readers	**Whipping boys:** Overleveraged individuals, over-eager lenders, government regulators, rating agencies	**Whipping boys:** Senate Republicans, particularly Richard C. Shelby

FROM LEFT: CHRIS KLEPONIS/AFP/GETTY IMAGES; CHESTER HIGGINS JR./THE NEW YORK TIMES; DANIEL ACKER/BLOOMBERG NEWS; YURI GRIPAS/AFP/GETTY IMAGES

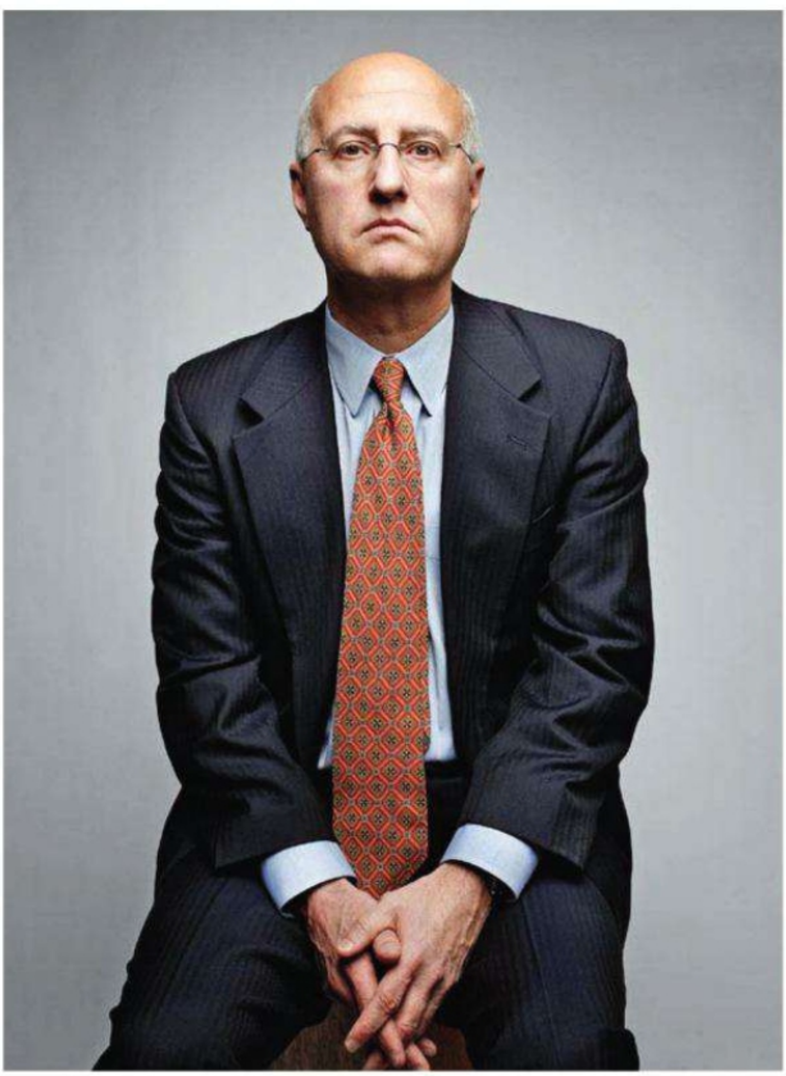
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Michael El-Hillow

"I wrote to the governor of Massachusetts, and we went to everyone we could think of–Congress, our banks. Nobody could help us"

Evergreen Solar's CEO on firing 800 workers, closing his U.S. factory, and the lure of lower costs and greater government subsidies in China



We make silicon wafers that go into solar panels. In 2008 we decided to build a plant in Massachusetts to be near our research and development facility. There was a groundswell of optimism that the U.S. was going to take the lead in the drive for alternative energy.

There were challenges from the start. Lehman Brothers was our banker and had almost a third of our outstanding shares as part of a financing transaction. That disappeared in Lehman's bankruptcy and cost us about $300 million. Then we went to the federal government to get help from the TARP funds, but they said no because we weren't a financial institution.

In December 2008 we were approached by a Chinese company, Jiawei, which was impressed with our wafer technology. The Chinese government agreed to support a loan that would cover two-thirds of our expansion in China. The subsidies we received from the government here covered less than 5 percent of the cost of our U.S. plant. We received $20 million and some future tax credits, but you can't pay taxes if you don't make money.

One mistake was making the U.S. facility too large. We should have made it a quarter the size. I wrote to the governor of Massachusetts, and we went to everyone we could think of–Congress, our banks. Nobody could help us. Then, late last year, prices went down 10 percent in one month for the modules we sell–on top of steadily falling prices for the last three years. That left us no choice but to stop making panels in the U.S. and shift our focus to making wafers in China. The access to capital for startups there is staggering.

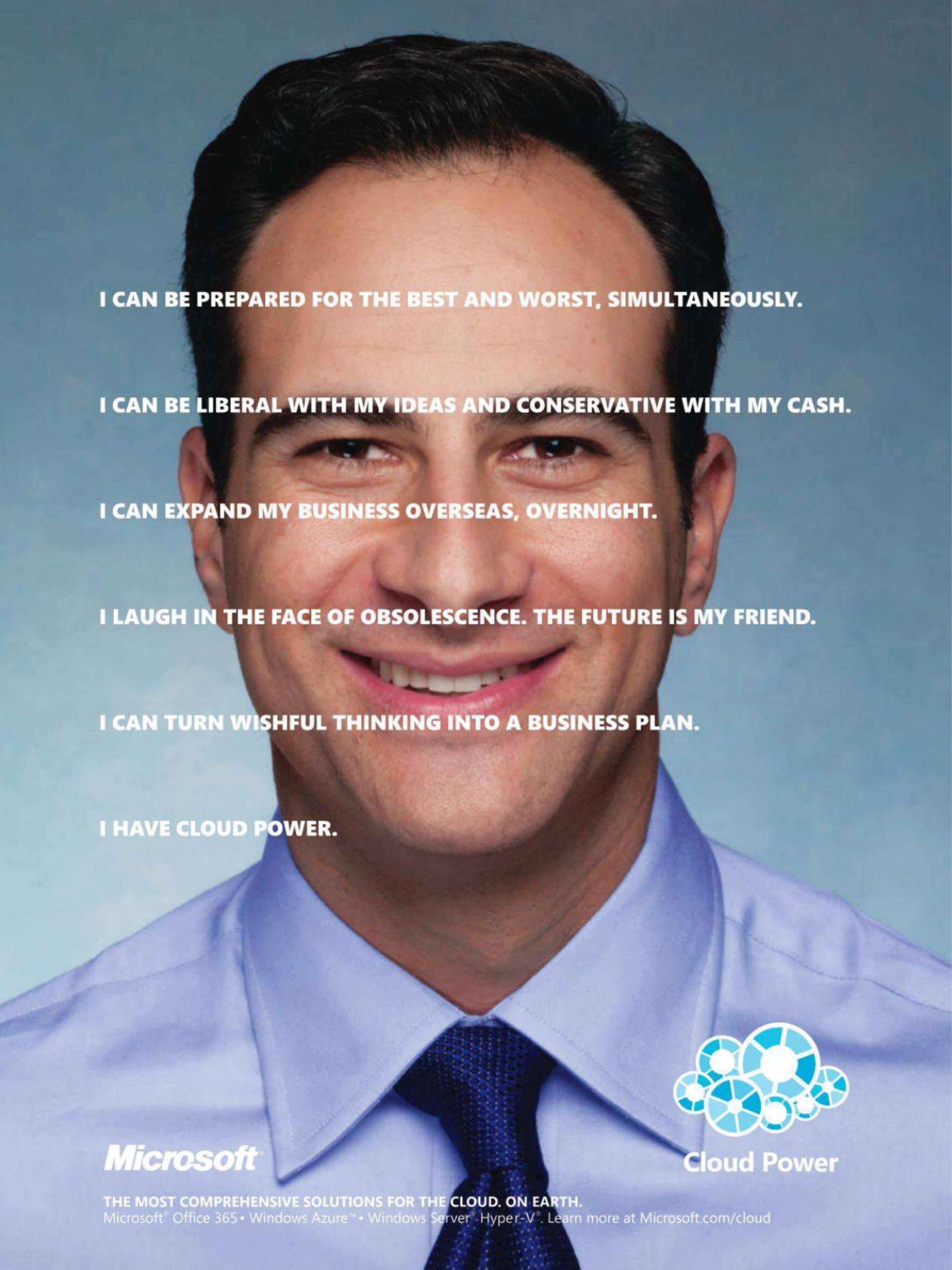
About 800 people in our U.S. factory will lose their jobs, but the company wouldn't have survived if we didn't make this choice. Now we'll focus on what we do best. If we had stayed here, we would have been insolvent by September. We needed to do this to survive, although my hope is that some day more jobs will come back here.

—As told to Diane Brady

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK

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HOW A STRATEGY TO HELP A TECHNOLOGY COMPANY GROW
IS HELPING BROADBAND REACH PLACES IT'S NEVER BEEN
PROGRESS IS EVERYONE'S BUSINESS
When a growing technology company was ready to sell shares to the public in order to raise capital, they needed a strategy. We identified ways to help them attract investors and utilize the additional capital to grow their business. Now they're devoting more of their resources to researching and developing new technologies—as well as bringing broadband to a growing network of businesses and their customers, no matter where they may be.
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I CAN BE PREPARED FOR THE BEST AND WORST, SIMULTANEOUSLY.
I CAN BE LIBERAL WITH MY IDEAS AND CONSERVATIVE WITH MY CASH.
I CAN EXPAND MY BUSINESS OVERSEAS, OVERNIGHT.
I LAUGH IN THE FACE OF OBSOLESCENCE. THE FUTURE IS MY FRIEND.
I CAN TURN WISHFUL THINKING INTO A BUSINESS PLAN.
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